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Wallinga, Marnix

*Published in:*  
European Review of Private Law

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*Document Version*  
Publisher's PDF, also known as Version of record

*Publication date:*  
2019

[Link to publication in University of Groningen/UMCG research database](#)

*Citation for published version (APA):*

Wallinga, M. (2019). Why MiFID & MiFID II do (not) matter to private law: Liability to Compensate for Investment Losses for Breach of Conduct of Business Rules . *European Review of Private Law*, 27(3), 515-556.

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## Why MiFID & MiFID II Do (not) Matter to Private Law: Liability to Compensate for Investment Losses for Breach of Conduct of Business Rules

Marnix WALLINGA\*

**Abstract:** The role of enforcement by civil courts of the Markets in Financial Instruments Directive (MiFID) and MiFID II conduct of business in contributing to retail investor protection is often overlooked at the EU level. The EU legislator, primarily, focuses on the harmonization of public enforcement by supervisory authorities through administrative law means. However, it can be argued that the (relative) lack of attention for judicial enforcement through private law means does not do justice to this enforcement avenue. This article, therefore, explores the potential of judicial enforcement through holding investment firms liable to pay damages on the basis of national private law to contribute to retail investor protection. The aim of the article is to establish the extent to which retail investors can invoke the MiFID and MiFID II conduct of business rules and, thereby, benefit from these rules in claiming damages. The article will argue, in the first place, that MiFID and MiFID II leave intact the freedom of Member States and civil courts to shape the effect of a breach of the conduct of business rules contained therein on a firm's private law liability to pay damages. However, that does not mean that the MiFID and MiFID II conduct of business rules are of no relevance to a firm's liability on the basis of national private law. The article will show that the private law regimes of the Netherlands, England & Wales, and Germany contain distinct avenues of judicial enforcement of the MiFID and MiFID II conduct of business rules through private law liability, which can significantly contribute to retail investor protection.

**Résumé:** Le rôle de l'application par les tribunaux civils des règles de conduite des directives MiFID et MiFID II pour contribuer à la protection de l'investisseur de détail est souvent négligé au niveau de l'UE. Le législateur de l'UE se focalise avant tout sur l'harmonisation de l'application dans la sphère publique par les autorités de contrôle grâce à des moyens de droit administratif. Toutefois, on peut soutenir que le manque d'attention (relatif) accordé à l'application judiciaire par des moyens de droit privé ne rend pas justice à cette possibilité d'application. Cet article étudie donc les possibilités de l'application judiciaire en tenant les entreprises d'investissement responsables du paiement de dommages et intérêts sur la base du droit national privé afin de contribuer à la protection de l'investisseur de détail. Le but de cet article est d'établir dans quelle mesure les investisseurs de détail peuvent faire appel aux règles de conduite des directives MiFID et MiFID II et bénéficier ainsi de ces règles en réclamant des dommages et intérêts. Cet article soutiendra en premier lieu que les directives MiFID et MiFID II n'entravent pas la liberté des États

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\* Postdoctoral Research Fellow and Coordinator of the Groningen Centre for European Financial Services Law, University of Groningen, The Netherlands. The final version of this contribution was submitted on 30 November 2018. Email: m.w.wallinga@rug.nl.

membres et des tribunaux civils à donner forme aux effets d'une violation des règles de conduite qu'elles contiennent sur la responsabilité de droit privé d'une entreprise à payer des dommages et intérêts. Toutefois, cela ne signifie pas que les règles de conduite des directives MiFID et MiFID II sont sans pertinence pour la responsabilité d'une entreprise sur la base du droit national privé. Cet article montrera que les régimes nationaux de droit privé des Pays-Bas, de l'Angleterre et du Pays de Galles, et de l'Allemagne contiennent des mécanismes d'application distincts qui relient les violations des règles de conduite des directives MiFID et MiFID II à la responsabilité de droit privé, ce qui peut contribuer de manière significative à la protection de l'investisseur de détail.

**Zusammenfassung:** Die Rolle der Zivilgerichte bei der Durchsetzung der MiFID- und MiFID II-Wohlverhaltensregeln als Beitrag zum Schutz der Kleinanleger wird auf EU-Ebene oft übersehen. Der EU-Gesetzgeber konzentriert sich in erster Linie auf die Harmonisierung der staatlichen Rechtsdurchsetzung durch die Aufsichtsbehörden mittels verwaltungsrechtlicher Mittel. Es lässt sich jedoch argumentieren, dass die (relativ) mangelnde Aufmerksamkeit für die gerichtliche Durchsetzung durch privatrechtliche Mittel diesem Durchsetzungsweg nicht gerecht wird. In diesem Artikel wird daher das Potenzial einer privatrechtlichen Durchsetzung im Rahmen einer auf der Grundlage des nationalen Privatrechts schadenersatzpflichtigen Wertpapierdienstleistungsunternehmen untersucht, um zum Schutz der Kleinanleger beizutragen. Mit dem vorliegenden Beitrag soll festgestellt werden, inwieweit sich Kleinanleger auf die MiFID- und MiFID II-Wohlverhaltensregeln berufen und damit von diesen Regeln bei der Geltendmachung von Schadenersatz profitieren können. In diesem Artikel wird zunächst argumentiert, dass MiFID und MiFID II die Freiheit der Mitgliedstaaten und Zivilgerichte unberührt lassen, die Wirkung eines Verstoßes gegen die darin enthaltenen Wohlverhaltensregeln für die privatrechtliche Schadenersatzpflicht einer Firma auszuarbeiten. Dies bedeutet jedoch nicht, dass die MiFID- und MiFID II-Wohlverhaltensregeln für die Haftung einer Firma auf der Grundlage des nationalen Privatrechts keine Relevanz haben. Der Beitrag zeigt, dass die nationalen privatrechtlichen Regelungen in den Niederlanden, England und Wales sowie Deutschland unterschiedliche Durchsetzungsmechanismen vorsehen, die einen Verstoß gegen die MiFID- und MiFID II-Wohlverhaltensregeln mit einer privatrechtlichen Haftung in Verbindung bringen, welche erheblich zum Schutz der Kleinanleger beitragen kann.

**Keywords:** MiFID (II), conduct of business rules, private law, liability to pay damages, investment losses, retail investor protection, investment services, comparative law.

**Mots clés:** Directive MiFID (II) (Directive concernant les marchés d'instruments financiers), Règles de conduite, Droit privé, Responsabilité/obligation de verser des dommages-intérêts, Pertes d'investissements, Protection de l'investisseur de détail, Services d'investissements, Droit comparé.

**Schlüsselwörter:** MiFID (II), Wohlverhaltensregeln, Privatrecht, Schadenersatzhaftung, Investitionsverluste, Kleinanlegerschutz, Wertpapierdienstleistungen, Rechtsvergleichung.

# 1. Introduction

1. Enforcement of the conduct of business rules contained in the 2004 ‘MiFID’<sup>1</sup> and the 2014 MiFID II<sup>2</sup> through holding firms liable to pay damages on the basis of national private law is often overlooked at the EU level.<sup>3,4</sup> These conduct of business rules, which include duties to avoid conflicts of interests, to provide adequate information, and to ensure the suitability of investments, are used in the EU as an instrument for realizing policy goals such as achieving a high level of investor protection and safeguarding the integrity and functioning of the financial system.<sup>5</sup> The EU legislator relies primarily on the harmonization of public enforcement by supervisory authorities through administrative law means of the ‘EU investor protection regulation’<sup>6</sup> embodied in the MiFID and MiFID II conduct of business rules in order to realize the objectives of the directives.<sup>7</sup> The rise of public

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- 1 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (*OJEU* 2004 L 145/1).
  - 2 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (*OJEU* 2014 L 173/349).
  - 3 This fits into a wider development in capital markets regulation where the regulatory space is often defined without sufficiently taking into account the role of enforcement by civil courts through private law means in realizing desired policy goals. See also N. MOLONEY, ‘Liability of Asset Managers: A comment’, *CMLJ (Capital Markets Law Journal)* 2012(4), p 416. More in general: F. CAFAGGI, ‘A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities’, in F. Cafaggi (ed.), *The Institutional Framework of European Private Law* (Oxford: OUP 2006), p 241. The most notable exception of this is the introduction of civil liability for credit rating agencies in the CRA Regulation, Art. 35a (Regulation (EU) No 462/2013). The 2003 Prospectus Directive, Art. 6 (Directive 2003/71/EC) and the 2017 Prospectus Regulation, Art. 11 (Regulation (EU) 2017/1129) also refer to the issue of civil liability, leaving the matter of shaping this to the discretion of the Member States.
  - 4 The term ‘civil courts’ is used to refer to courts in not only civil law, but also common law jurisdictions.
  - 5 This strategy fits into the wider development of what has been called by Micklitz ‘European regulatory private law’. The concept refers to the use of private law for regulatory purposes at the EU level. Private law is understood here in a wide sense as embracing all legal rules that govern the relationships and the dealings between private parties irrespective of the nature of the law – public or private – in which they are transposed in the national legal system. See H.-W. MICKLITZ, ‘The Visible Hand of European Regulatory Private Law – The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation’, *YEL (Yearbook of European Law)* 2009(1); H.-W. MICKLITZ, ‘The Concept of Competitive Contract Law’, *PSILR (Penn State International Law Review)* 2005(3), pp 554 & 555.
  - 6 See also for the use of this term: O.O. CHEREDNYCHENKO, ‘Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law’, *ELJ (European Law Journal)* 2015(4); N. MOLONEY, ‘The Investor Model Underlying the EU’s Investor Protection Regime: Consumers or Investors’, *EBOR (European Business Organization Law Review)* 2012(2).
  - 7 See in more detail s. 2.

enforcement by supervisory authorities of these regulatory conduct of business rules that set standards of behaviour in the private law relationship between firms and their clients and aim at protecting the latter, has resulted in the development of what Cherednychenko has described as ‘European supervision private law’.<sup>8</sup> Furthermore, the EU legislator has been promoting the use of out-of-court enforcement mechanisms of EU investor protection regulation as a substitution for enforcement by civil courts.<sup>9</sup> Moreover, as part of the ‘New Deal for Consumers’,<sup>10</sup> the Commission is currently promoting the use of collective redress in the area of investor protection covered by MiFID II.<sup>11</sup> The Commission’s Proposal for a directive on collective redress for the protection of collective interests of consumers is aimed at enabling qualified entities to bring representative actions to seek redress on behalf of groups of consumers before civil courts or administrative authorities.

2. There are multiple possible reasons why judicial enforcement through the imposition of liability to pay damages grounded in private law is often overlooked in the context of EU investor protection regulation.<sup>12</sup> The first and most likely one seems to be related to the difficulty to establish competence to provide for the harmonization of liability rules in EU legislative measures due to the tension between the EU and Member States over the control of general private law. The resistance at the Member State level to the harmonization of national private law combined with the fact that the EU Treaties do not provide a genuine legislative competence to harmonize general private law may explain why the EU often resorts to public law.<sup>13</sup> Another possible reason lies in the assumption that this mode of enforcement (alone) would be incapable of realizing policy goals such as the desired

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8 O.O. CHEREDNYCHENKO, ‘Public Supervision over Private Relationships: Towards European Supervision Private Law?’, *ERPL* 2014(1).

9 O.O. CHEREDNYCHENKO, ‘Public and Private Enforcement of European Private Law in the Financial Services Sector’, *ERPL* 2015(4), p 638; H.-W. MICKLITZ, ‘The Transformation of Enforcement in European Private Law: Preliminary Considerations’, *ERPL* 2015(4), p 508; O.O. CHEREDNYCHENKO, ‘Public and Private Enforcement of European Private Law: Perspectives and Challenges’, *ERPL* 2015(4), p 485.

10 Press Release on A New Deal for Consumers: Commission strengthens EU consumer rights and enforcement, 11 April 2018, see [http://europa.eu/rapid/press-release\\_IP-18-3041\\_en.htm](http://europa.eu/rapid/press-release_IP-18-3041_en.htm) (accessed 25 August 2018).

11 Proposal for a Directive of the European Parliament and of the Council on representative actions for the protection of the collective interests and repealing Directive 2009/22/EC (COM(2018) 184), Art. 2(1) jo. Annex I sub 45.

12 The term ‘judicial enforcement’ is used in this article to refer to civil courts where private individuals can bring a claim for compensation of damages.

13 D. CARUSO, ‘The Missing View of the Cathedral: The Private Law Paradigm of European Legal Integration’, *ELJ* 1997(1). See also H.-W. MICKLITZ, ‘Administrative Enforcement of European Private Law’, in R. Brownsword et al. (eds), *The Foundations of European Private Law* (Oxford & Portland: Hart Publishing 2011), p 585.

level of investor protection.<sup>14</sup> Yet another potential reason might be that industry lobbies against this form of enforcement in the light of expected increased costs.<sup>15</sup>

3. The private law liability of firms could, nevertheless, offer a particularly valuable instrument to contribute to the protection of retail investors, who rely on investing in the financial markets for their welfare provision and long-term financial planning,<sup>16</sup> against the mis-selling of investment product alongside public enforcement through administrative law means. In any case, it is widely recognized by scholars that a combination of (*ex ante*) deterrence-oriented public supervision and administrative enforcement and (*ex post*) compensation-oriented judicial enforcement is essential for achieving desired policy goals.<sup>17</sup>

4. This article, therefore, explores the potential of judicial enforcement through holding investment firms liable to pay damages based on national private law to contribute to retail investor protection. The aim of this article is to establish the extent to which retail investors can invoke the MiFID and MiFID II conduct of business rules and, thereby, benefit from them in bringing a claim for damages against investment firms. It will be argued that although Member States and civil courts remain free to shape the effect of a breach of the MiFID and MiFID II conduct of business rules on a firm's liability to pay damages, national private law regimes contain distinct gateways to the effect of these rules on private law liability which can contribute to retail investor protection. The focus in this article is on the 'classical' conduct of business rules contained in MiFID, and specified in the MiFID Implementing Directive,<sup>18</sup> which have been incorporated in MiFID II, and further elaborated in a MiFID II Delegated Regulation,<sup>19</sup> such as the mentioned information disclosure duty and the suitability rule.<sup>20</sup> The information disclosure duty requires investment firms

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14 See also O.O. CHEREDNYCHENKO, 'Financial Services Sector', *ERPL* 2015, p 621; I.G. MACNEIL, 'Rethinking conduct regulation', *JIBFL (Journal of International Banking and Financial Law)* 2015(7), p 414; O.O. CHEREDNYCHENKO, *ERPL* 2014, p 4.

15 M. ANDENAS & I.H.-Y. CHIU, *The Foundations and Future of Financial Regulation* (Oxford: Routledge 2014), p 223; N. MOLONEY, *CMLJ* 2012, p 421.

16 N. MOLONEY, *How to Protect Investors* (Cambridge: CUP 2010), pp 2 & 39.

17 F. WEBER & M. FAURE, 'The Interplay Between Public and Private Enforcement in European Private Law: Law and Economics Perspective', *ERPL* 2015(5); O.O. CHEREDNYCHENKO, 'Financial Services Sector', *ERPL* 2015, pp 640 et seq.; H.E. JACKSON & M.J. ROE, 'Public and Private Enforcement of securities laws: Resource-based evidence', *JoFE (Journal of Financial Economics)* 2009(2); R. LA PORTA, F. LOPEZ-DE-SILANES & A. SHLEIFER, 'What Works in Securities Laws', *JoF (The Journal of Finance)* 2006(1); H. COLLINS, *Regulating Contracts* (Oxford: OUP 2002), pp 61 & 62; S. SHAVELL, 'Liability for Harm versus Regulation of Safety', *JoLS (Journal of Legal Studies)* 1984(2), p 365.

18 Commission Directive 2006/73/EC (*OJEU* 2006 L 241/26).

19 Commission Delegated Regulation (EU) 2017/565 (*OJEU* 2017 L 87/1).

20 Art. 19 MiFID, Arts 24 & 25 MiFID II.

to provide information, in particular about the risks associated with a certain investment service or financial product, in order to allow retail investors to make a well-informed investment decision. The suitability rule, in short, requires firms to obtain information about the client's characteristics and to ensure that the service or product provided fits those characteristics.

5. Against this background, in the following, I will first take a closer look at the relationship between the MiFID and MiFID II conduct of business rules and liability of firms to pay damages on national private law from the angle of what the directives require from Member States in terms of their implementation (s. 2). The article then turns to two avenues of enforcement through holding firms liable to pay damages for breach of the MiFID and MiFID II conduct of business rules by using examples from Dutch, English, and German law.<sup>21</sup> The first category is liability for a breach of an unwritten duty of care (s. 3), the second one is liability for a breach of a statutory provision requiring certain conduct (s. 4). These two categories of enforcement can contribute to retail investor protection by providing for a gateway to either an 'indirect' and a more 'direct' effect of the regulatory conduct of business rules on the private law liability of firms to pay damages. Finally, I will summarize the main findings of this article and conclude with an outline of further research into the potential of judicial enforcement of the MiFID and MiFID II conduct of business to contribute to retail investor protection (s. 5).

## **2. MiFID (II): Why the Directives Do Not Matter to Private Law**

### ***2.1. Implementation of MiFID and MiFID II in National Law***

6. The interaction between the MiFID and MiFID II conduct of business rules and liability of firms to pay damages based on private law depends on what MiFID and MiFID II require from Member States in terms of their implementation due to the fact that the conduct of business rules are laid down in a directive.<sup>22</sup> Directives must, in principle, be implemented into the national legal system to have effect in private law.<sup>23</sup> In transposing directives, Member States are required to take all appropriate measures to realize the result aimed for by the regulatory measure.<sup>24</sup> This duty of sincere cooperation is binding on

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21 English law is understood as the legal system of England and Wales.

22 As mentioned, the Commission has specified the MiFID II conduct of business rules in a delegated Regulation (No. 2017/565). In the light of the hierarchy between the measure in which a delegated rule-making power is laid down and a delegated act which is adopted under that power, the fact that the MiFID II conduct of business rules regime is laid down in a Directive should be the guiding principle in establishing its relationship with private law.

23 See more in general about Directives: S. PRECHAL, *Directives in EC Law* (Oxford: OUP 2005).

24 Art. 4(3) TFEU. See in more detail: R. SCHÜTZE, *European Constitutional Law* (Cambridge: CUP 2012), p 331.



all authorities of the Member States, including civil courts when adjudicating disputes.<sup>25</sup> Member States are generally free to choose the form – public law, private law, or a combination of both – in which they translate directives into national law.<sup>26</sup> This can be explained by the fact that directives are binding (only) as to the result to be achieved.<sup>27</sup> The freedom of implementation can be restricted in certain cases, if necessary in order to realize the objectives of the directive. In more concrete terms, the question that needs to be answered is what must be transposed into national law, in what manner, and with what intensity to ensure the realization of the objectives of the directives at the Member State level. Therefore, it needs to be established what the harmonization scope of MiFID and MiFID II is and to what degree these directives aim to harmonize what falls within that scope.

7. In the light of the harmonization scope of MiFID and MiFID II, the degree of harmonization of these directives appears to be of secondary importance in determining the interaction between the MiFID and MiFID II conduct of business rules and private law liability to pay damages. Considering Article 24(12) MiFID II, which under the MiFID regime was contained in the MiFID Implementing Directive,<sup>28</sup> combined with the silence and the ambiguity of MiFID in this regard, the directives can be said not to be aimed at realizing full or maximum *de jure* harmonization.<sup>29</sup> The increased reliance on soft law by the ESMA combined with the stronger nature of its convergence efforts, as well as the laying down by the Commission of the conduct of business rules in a directly applicable Commission Delegated Regulation,<sup>30</sup> can,

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25 CJEU 10 April 1984, ECLI:EU:C:1984:153, C-14/83 (*Von Colson*), para. 26. See also on this in more detail: R. SCHÜTZE, *European Union Law*, pp 395 et seq.; S. PRECHAL, ‘National Courts in EU Judicial Structures’, *YEL* 2006(1); S. PRECHAL, *Directives in EC Law*, pp 132 et seq.

26 S. PRECHAL, *Directives in EC Law*, pp 73 et seq. See also M. DOUGAN, ‘The Impact of the General Principles of Union Law upon Private Relationships’, in D. LECZYKIEWICZ & S. WEATHERILL (eds), *The Involvement of EU Law in Private Law Relationships* (Oxford and Portland: Hart Publishing 2013), p 73.

27 Art. 288 TFEU.

28 Art. 4 MiFID Implementing Directive (Commission Directive 2006/73/EC).

29 In more detail: M.W. WALLINGA, ‘Invloed van Europese *soft law* op privaatrechtelijke normstelling op het gebied van financiële dienstverlening’, *NTBR (Nederlands Tijdschrift voor Burgerlijk Recht)* 2015(40); M.W. WALLINGA, ‘Financiële dienstverlening, publiekrechtelijke gedragsregels en privaatrechtelijke normstelling: lessen uit Duitsland en Europa’, *NTBR* 2014(35). See also the decision of the CJEU in *Nationale Nederlanden v. Van Leeuwen* (ECLI:EU:C:2015:286), in which it considered the implications of a comparable provision contained in the third life assurance Directive. Differently: D. BUSCH, ‘The Private Law Effect of MiFID: The Genil Case and Beyond’, *ERCL* 2017 (1), pp 80 & 81; O.O. CHEREDNYCHENKO, ‘Full Harmonization of Retail Financial Services Contract Law in Europe’, in S. Grundmann & Y.M. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law* (Alphen aan den Rijn: Kluwer Law International 2011), p 243.

30 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational



nevertheless, be considered as a signification towards further (*de facto*) harmonization.<sup>31</sup>

## 2.2. Harmonization Scope

### 2.2.1. General

8. The harmonization scope of a directive can be considered as determining its 'legislative field'.<sup>32</sup> Issues that fall outside that field are, in principle, not harmonized by the directive. Member States retain the freedom to shape national law with respect to those issues. What exactly falls within the harmonization scope of MiFID and MiFID II has generated an interesting scholarly debate.<sup>33</sup>

### 2.2.2. Focus on Public Supervision and Administrative Enforcement

9. MiFID and MiFID II are drafted primarily from the perspective of public enforcement by supervisory authorities through administrative law means. The directives focus on providing investment firms access to financial markets across the EU and ensuring the implementation of the appropriate public supervision structures and administrative enforcement mechanisms.

MiFID and MiFID II require Member States to designate public competent authorities to carry out the duties formulated in these directives and to provide these authorities with all the necessary supervisory powers to fulfil these duties.<sup>34</sup> The public supervisory authorities are to be provided with the power to impose effective,

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requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (*OJEU* 2017 L 87/1).

31 These efforts aim at contributing to the establishment of the single rulebook for EU financial markets. See also on this: N. MOLONEY, *EU Securities and Financial Markets Regulation* (Oxford: OUP 2014), pp 339 et seq.; N. MOLONEY, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making', *EBOR* 2011(1), p 64.

32 See about this in further detail: R. SCHÜTZE, *European Union Law* (Cambridge: CUP 2015), p 550.

33 See for example: M.W. WALLINGA & A.C.W. PIJLS, 'De wisselwerking tussen Europees financieel toezichtrecht en nationaal privaatrecht. De indirecte invloed van de MiFID II op privaatrechtelijke aansprakelijkheid op het gebied van beleggingsdienstverlening en de onderbelichte invloed van de regeling OHP', *RMThemis (Rechtsgeleerd Magazijn Themis)* 2018(1); M.W. WALLINGA & O.O. CHEREDNYCHENKO, 'Naschrift: harmonisatie van het nationale privaatrecht door de Derde levensrichtlijn', *NTBR* 2016(28), p 191; O.O. CHEREDNYCHENKO, 4. *ELJ* 2015, pp 504 et seq.; M.W. WALLINGA, *NTBR* 2015; J. FORSCHNER, *Wechselwirkungen von Aufsichtsrecht und Zivilrecht. Eine Untersuchung zum Verhältnis der § 31ff. WpHG und zivilrechtlichen Beratungsvertrag* (doctoral thesis) (Tübingen: Mohr Siebeck 2013), pp 39 et seq. & 61; O.O. CHEREDNYCHENKO, in *Financial Services, Financial Crisis and General European Contract Law*, pp 247 et seq.; M. TISON, 'De bescherming van de belegger in het kapitaalmarktrecht: de hobbelige weg naar een Europees *Ius commune*', *WP* 2008(07), pp 8 et seq.

34 Art. 48 MiFID, Art. 50 MiFID; Art. 67 MiFID II, Art. 69 MiFID II.

proportionate, and dissuasive administrative sanctions and measures in order to enforce the conduct of business rules.<sup>35</sup> The focus on public supervision over the relationship and administrative enforcement of the aspects regulated by MiFID II is further illustrated by the Commission's more general push in the area of financial services to realize 'efficient and sufficiently' harmonized administrative sanctioning regimes throughout the EU.<sup>36</sup> In addition, MiFID and MiFID II require Member States to provide the possibility for specified bodies to take action before a court or competent authority in the interests of investors and to set-up procedures for the out-of-court enforcement of EU investor protection regulation.<sup>37</sup>

10. At the same time, MiFID and MiFID II remain silent on the liability of firms to provide retail investors compensation for investment losses for breach of the conduct of business rules.<sup>38</sup> The directives do not state how the relationship between breach of the conduct of business rules regimes and enforcement by civil courts through holding firms liable to pay damages in private law should be shaped. Combined with the focus in the directives on shaping public enforcement by supervisory authorities through administrative law means, this indicates that the harmonization scope of the directives does not extend to judicial enforcement through private law means.

### 2.2.3. *No Principle of Civil Liability*

11. This appears to have been underlined during the consultation phase leading up to the adoption of MiFID II. The Commission requested input on whether a 'principle of civil liability applicable to investment firms' was to be introduced in MiFID II.<sup>39</sup> The Commission considered that while investment firms are subject to possible administrative enforcement actions by national supervisory authorities for breach of MiFID rules, MiFID does not deal with the liability of these firms in situations where breach of the conduct of business rules causes damage to

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35 Art. 51(1) MiFID; Art. 70 MiFID II.

36 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Reinforcing sanctioning regimes in the financial services sector (COM(2010) 716), p 2.

37 Art. 52(2) MiFID, Art. 53 MiFID which states that Member States shall 'encourage' the setting-up of extra-judicial mechanisms; Art. 74(2) MiFID II, Art. 75 MiFID II which states that Member States shall 'ensure' such setting-up. See more in general about promotion by the EU legislator of the use of out-of-court enforcement mechanisms of EU investor protection regulation as a substitution for enforcement by civil courts: O.O. CHEREDNYCHENKO, 'Financial Services Sector', *ERPL* 2015, p 638; H.-W. MICKLITZ, *ERPL* 2015, p 508; O.O. CHEREDNYCHENKO, 'Perspectives and Challenges', *ERPL* 2015, p 485.

38 In the same vein: O.O. CHEREDNYCHENKO, *ELJ* 2015, p 505.

39 Commission, *Public Consultation. Review of the Markets in Financial Instruments (MIFID)* (Brussels 8 December 2010), p 63.

investors. The Commission stated that the conditions for liability of firms to compensate retail investors for investment losses varied in the Member States. According to the Commission, the introduction of a principle of civil liability was vital in realizing an equal level of investor protection across the EU.<sup>40</sup> This proposal was, however, rejected.<sup>41</sup>

12. By suggesting such a principle of civil liability and by considering that MiFID does not deal with the conditions for liability of firms to pay damages, the Commission recognizes that private law norms that determine whether an investment firm is liable in private law fall outside the MiFID's harmonization scope. The rejection of the principle of civil liability offers a further indication of that judicial enforcement of the conduct of business rules through private law liability does not fall within the harmonization scope of MiFID and MiFID II.

#### 2.2.4. *Genil v. Bankinter*

13. *Genil v. Bankinter* is the first case in which the Court of Justice of the European Union (hereafter: the 'CJEU') sheds light on its position on the relationship between EU investor protection regulation and private law and is relevant for determining MiFID's harmonization scope.<sup>42</sup> The question referred to the CJEU focuses on the contractual consequences of breach of the MiFID suitability rule.<sup>43</sup> This rule requires firms, prior to the entering into of a contract regarding a financial instrument with an investor, to acquire information about certain characteristics of the client to be able to establish whether the intended instrument fits these characteristics.

14. In its decision, the CJEU holds that there is an absence of EU legislation with regard to contractual consequences of the conduct of business rules contained in MiFID.<sup>44</sup> The CJEU appears to emphasize the freedom of Member States to choose whether to provide an enforcement mechanism grounded in private law as the Court regards this choice as a matter, in principle, of the internal legal order.<sup>45</sup>

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40 Commission, *Public Consultation*, p 63.

41 In more detail: N. MOLONEY, *CMLJ* 2012, p 421.

42 CJEU EU 30 May 2013, ECLI:EU:C:2013:344, C-604/11 (*Genil v. Bankinter*), annotated by, *inter alia*, S. GRUNDMANN, 'The Bankinter Case on MIFID Regulation and Contract Law', *ERCL* 2013(9).

43 CEU 30 May 2013, ECLI:EU:C:2013:344 (*Genil v. Bankinter*).

44 CJEU 30 May 2013, ECLI:EU:C:2013:344 (*Genil v. Bankinter*), para. 57.

45 Similarly: G. SPINDLER, 'Grundlagen', in K. Langenbucher, D.H. Bliesener & G. Spindler (eds), *Bankrechts-Kommentar* (München: C.H. Beck 2016), no. 28a. See differently: S. GRUNDMANN, *ERCL* 2013, p 278, who focuses on the wording by the CJEU in para. 58 and suggests that it be interpreted as that Member States are left with only the freedom to choose *which* contractual consequences they would want to impose. This would imply, according to Grundmann that Member States do not have the freedom to choose whether a contractual consequence should be applied at all to breach of MiFID conduct of business rules.

The freedom of choice in this regard is further supported by the CJEU's focus on Article 51 MiFID when answering the preliminary question. This provision, which has been laid down in similar terms in Article 70 MiFID II, requires Member States to provide in national law for the possibility to sanction breach of MiFID rules through administrative measures or sanctions. According to the CJEU, the provision does not prescribe Member States to provide for contractual consequences in case of breach of the conduct of business rules, or what those might be.

The CJEU provides the question as to whether a breach of EU investor protection regulation results, or should result, in contractual consequences with a public supervision and administrative enforcement-oriented answer.<sup>46</sup> The focus on Article 51 MiFID in this context can be explained as that the Court considers that the effectiveness of MiFID is adequately ensured when the national legal system enables supervisory authorities to enforce the regulatory conduct of business rules through the administrative measures as prescribed by the directive.<sup>47</sup> As such, the judgment can be interpreted as an illustration of that the harmonization scope of the directive is restricted to public enforcement by supervisory authorities through administrative law means and does not extend to the liability of firms in private law to pay damages.<sup>48</sup>

15. The CJEU expands on its course in *Hirrmann v. Immofinanz*. The case revolves, as relevant for present purposes, around the consequences for private law of the Prospectus Directive.<sup>49</sup> Comparable to MiFID, the Prospectus Directive contains a provision that requires Member States to transpose into national law a mechanism that enables supervisory authorities to enforce the standards laid down in the directive through administrative sanctions and measures.<sup>50</sup> The CJEU similarly seems to emphasize the freedom of Member States to shape the private law response to breach of the duties derived from the Prospectus Directive.<sup>51</sup>

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46 *Genil v. Bankinter*, para. 57. See in further detail: M.W. WALLINGA, *NTBR* 2014, ss 4 & 5.2.

47 See in more detail: M.W. WALLINGA, *NTBR* 2014, ss 4 & 5.2. Similarly: BGH 17 September 2013, *XI ZR 332/12*, paras 30 & 31, *WM* 2013, 1983. Differently: D. BUSCH, *ERCL* 2017.

48 Similarly: T.M.J. MÖLLERS & M.C. POPPELE, 'Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote', *ZGR (Zeitschrift für Unternehmens- und Gesellschaftsrecht)* 2013(4), pp 467 & 468; T.M.J. MÖLLERS, 'European Legislative Practice 2.0: Dynamic Harmonisation of Capital Markets Law - MiFID II and PRIIP', *B&FLR (Banking & Finance Law Review)* 2015, p 165; BGH 17 September 2013, *XI ZR 332/12*, *WM* 2013, 1983, no. 27 et seq.

49 CJEU 19 December 2013, ECLI:EU:C:2013:856.

50 Art. 25 Prospectus Directive. In contrast to MiFID, the Prospectus Directive does appear to contain a provision pertaining to private law. Art. 6(2) Prospectus Directive requires Member States to ensure that 'their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus'.

51 CJEU 19 December 2013, ECLI:EU:C:2013:856, no. 39 & 40. Similarly: M. HAENTJENS, 'Incoherentie verenigd. Privaatrechtelijke concepten onder druk van Europees financieel recht', *TPR (Tijdschrift voor Privaatrecht)* 2017(4), no. 59; *Ondernemingsrecht* 2014/71, *Hirrmann v. Immofinanz*, annotated by T.M.C. Arons, para. 3.2.

16. In the end, nevertheless, the CJEU refrains from making a definitive choice in *Genil v. Bankinter* regarding the relationship between the MiFID conduct of business rules and private law. This can be due to the rather specific way the referring court formulated its question or that the CJEU was reluctant to adopt a one-size-fits-all approach to an issue as the relationship between EU investor protection regulation and national private law in the light of MiFID's emphasis on public supervision and administrative enforcement.<sup>52</sup>

### 2.2.5. *Article 69(2) MiFID II and the Principle of Effectiveness*

17. In the meantime, MiFID II contains an intriguing, novel element in the form of Article 69(2) final part MiFID II.<sup>53</sup> The provision requires Member States to provide in national law for a mechanism under which compensation can be paid or other remedial action can be taken in case financial loss or damage is incurred as a result of breach of MiFID II and Markets in Financial Instruments Regulation. The provision seems not concerned with judicial enforcement of the regulatory conduct of business rules through private law means, but rather with administrative enforcement of the EU investor protection regulation. This can be derived from the fact that the obligation imposed on Member States is laid down in a provision on the supervisory powers that competent authorities should be provided with. Support for this can be found in the Recommendation in which the obligation was proposed by the European Parliament Committee on Economic and Monetary Affairs.<sup>54</sup> The proposed addition, which ended up in the final part of the second paragraph of Article 69 MiFID II, ranks among the administrative enforcement and sanctioning powers which supervisory authorities were to be equipped with.

18. In addition, the mechanism calls to mind the extensive investor compensation powers of the English regulator, the Financial Conduct Authority.<sup>55</sup> As a result of the mis-selling of interest rate swaps to small and medium-sized enterprises in the Netherlands, it has been proposed that the Dutch regulator, the Authority for the Financial Markets, be provided with a similar power to appoint experts to conduct research into past behaviour of regulated firms and to impose collective redress schemes in case of widespread mis-selling.<sup>56</sup> These powers have in common that

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<sup>52</sup> In this regard: O.O. CHEREDNYCHENKO, *ELJ* 2015, p 505; S. GRUNDMANN, *ERCL* 2013, p 275.

<sup>53</sup> Recommendation by the Committee on Economic and Monetary Affairs for First Reading, 5 October 2012 (A7-0306/2012) (MiFID II), Art. 72(ha).

<sup>54</sup> A7-0306/2012.

<sup>55</sup> The FCA can award restitution to investors or apply to the court for such an award as well as require firms to operate a redress scheme for widespread mis-selling (FSMA 2000, s. 382, 384, and. 404-404G).

<sup>56</sup> AFM, *Wetgevingsbrief* (Amsterdam 27 June 2016), pp 6 & 7. Ministry of Finance, *Kamerbrief: Resultaten consultatie effectiviteit en gewenste mate van bescherming voor zzp-ers en mkb-ers bij financiële diensten en producten en vervolgstappen* (The Hague 12 April 2017).

they do not entitle investors to bring an action for compensation based on private law, but provide supervisory authorities with the power to ensure redress through administrative law means, which fits into the wider development of increased focus of public enforcement on compensation.<sup>57</sup> Accordingly, Article 69(2), final part MiFID II can be interpreted as requiring Member States to provide in national law for an administrative enforcement mechanism that enables supervisory authorities to investor redress.<sup>58</sup> This offers another indication of that the harmonization scope of MiFID II is restricted to public enforcement by supervisory authorities through administrative law means.

19. The characterization of Article 69(2), final part MiFID II as a codification of the European principle of effectiveness cannot as such alter or supplement the harmonization scope of the directive to bring liability based on private law within this scope.<sup>59</sup> Under the principle of effectiveness, the enforcement of the MiFID and MiFID II conduct of business rules cannot be rendered excessively difficult or virtually impossible.<sup>60</sup> The line of reasoning that MiFID and MiFID II on the basis of the (codification of the) principle of effectiveness also come to harmonize private law liability is based on the assumption that national law, in the event only enforcement through the means available within (public) administrative law is harmonized, will be incapable of realizing the objectives of the directives. However, considering the predominant focus of the directives on public supervision and administrative enforcement, the adoption of the requirement of Article 69(2), final part MiFID II can be understood as that the effectiveness of the directives could be sufficiently ensured through administrative enforcement and equipping national regulatory authorities with the enforcement tools prescribed by Article 50 MiFID & Article 69 MiFID II.<sup>61</sup>

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57 See in more detail including further references: F. CAFAGGI & H.-W. MICKLITZ, 'Introduction', in F. CAFAGGI & H.-W. MICKLITZ (eds), *New Frontiers of Consumer Protection. The Interplay Between Private and Public Enforcement* (Oxford: Intersentia 2009), p 5; F. CAFAGGI, in *The Institutional Framework of European Private Law*, p 202.

58 In the same vein: F. DELLA NEGRA, 'The Effects of the ESMA's Powers on Domestic Contract Law', in M. Andenas & G. Deipenbrock (eds), *Regulating and Supervising European Financial Markets: More Risks than Achievements* (Berlin/Heidelberg: Springer 2016), p 155.

59 See apparently differently: D. BUSCH, *ERCL* 2017, pp 74 & 75.

60 CJEU 16 December 1976, ECLI:EU:C:1976:188, C-33/76 (*Rewe-Zentralfinanz*), para. 5; CJEU 16 December 1976, ECLI:EU:C:1976:191, C-45/76 (*Comet*), para. 16; CJEU 9 November 1983, ECLI:EU:C:1983:317, C-199/82 (*San Giorgio*), para. 14. See also CJEU 19 July 2012, ECLI:EU:C:2012:478, C-591/10, para. 28; CJEU 20 September 2001, ECLI:EU:2001:465, C-453/99, para. 29. See also CJEU 19 July 2012, ECLI:EU:C:2012:478, C-591/10 (*Littlewoods*), no. 27; HvJEU 20 september 2001, ECLI:EU:C:2001:465, C-453/99 (*Courage v. Crehan*), no. 29.

61 M.W. WALLINGA, *NTBR* 2015, s. 5.2. In a similar sense: H.C. GRIGOLEIT, 'Anlegerschutz - Produktinformationen und Produktverbote', *ZHR (Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht)* 2013(02-03), p 275. Furthermore, retail investors could, for instance, invoke the conduct of business rules when bringing a claim for damages based on national private law (see in more detail: ss 3 & 4). In addition, national law can contain alternative mechanisms

### 3 Liability for Breach of an Unwritten Duty of Care: Indirect Effect on Liability

#### 3.1. General

20. The previous section has shown that judicial enforcement through private law means falls outside the harmonization scope of MiFID and MiFID II. Member States and civil courts, therefore, remain free to shape the effect of a breach by an investment firm of the MiFID and MiFID II conduct of business rules on the firm's liability in private law to pay damages. However, this does not mean that these conduct of business rules are of no relevance to judicial enforcement through holding firms liable to pay damages. Retail investors might be able to invoke the conduct of business rules when bringing an action for damages. The Member States under investigation contain mechanisms that can allow retail investors to invoke the conduct of business rules when bringing a claim for damages. Nevertheless, the examples from Dutch, English, and German law reveal differences in the extent to which retail investors can invoke the conduct of business in practice and, hence, the extent to which these rules can contribute to investor protection.

21. The avenues of judicial enforcement through holding firms liable to pay damages for breach of the conduct of business rules in the Member States can be divided into two categories. On the one hand, there is liability for a breach of an unwritten duty of care. On the other hand, there is liability for a breach of a statutory rule requiring certain conduct. Liability for breach of an unwritten duty of care can provide a gateway to a more 'indirect' effect of the regulatory conduct of business rules on liability of firms to pay damages. This indirect effect, which will be discussed in this paragraph, is based on the interaction between the conduct of business rules and the duty of care imposed on firms in national private law. The more 'direct' effect, which relates to liability for breach of a statutory duty, will be discussed in section 4.

#### 3.2. The Netherlands

##### 3.2.1. Special Duty of Care and Breach of Contract

22. The *Hoge Raad* (the Dutch Supreme Court) has held that investment firms can be under an unwritten special duty of care when providing financial services to retail clients.<sup>62</sup> Violation of the special duty of care can constitute breach of contract, which allows the investor to claim damages in contract law

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that contribute to investor protection in relation to breach of the conduct of business rules such as termination or avoidance of the contract regarding the purchase of an investment product, forms of out-of-court dispute settlement, and tools of supervisory authorities potentially including the power to provide for investor redress.

62 With further references about the development of this duty of care: M.W. WALLINGA, 'De bijzondere zorgplicht: de looper van het verbintenissenrecht op financieel gebied?', *WPNR (Weekblad voor Privaatrecht, Notariaat en Registratie)* 2016(7116).



(Art. 6:74 *Burgerlijk Wetboek*, hereafter: ‘BW’).<sup>63</sup> The effect of the special duty of care is not restricted to contractual liability, but also extends to non-contractual liability (Art. 6:162 BW). The special duty of care can apply in situations where parties have entered into a contractual relationship, but also in situations where such a relationship does not (yet) exist, such as in the precontractual phase.<sup>64</sup> Retail investors when bringing an action for damages against an investment firm, generally, base their claim on breach of this duty of care.

23. The special duty of care requires, essentially, that the investment firm in its capacity as a particularly professional and expert party provides retail investors with protection against themselves.<sup>65</sup> The special duty of care is not restricted to one particular type of relationship but has been applied by the *Hoge Raad* in relation to the provision of execution only, asset management, and investment advisory services. The special duty of care functions as a container of more specific requirements for investment firms to comply with in the provision of their services to retail investors.<sup>66</sup> The *Hoge Raad* has, for example, derived from the special duty of care an information disclosure duty and a suitability rule which are similar to the conduct of business rules contained in MiFID and MiFID II.<sup>67</sup> The special duty of care has a contextual nature, which means that its existence and scope depend on the particular circumstances of the specific case.<sup>68</sup>

### 3.2.2. *Interplay with Regulatory Conduct of Business Rules*

24. The MiFID and MiFID II conduct of business rules as transposed into the Dutch financial supervision framework can help retail investors in bringing a claim for damages in liability based on private law on account of the

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63 See in more detail about the mechanisms involved: M.W. WALLINGA, *WPNR* 2016, pp 608 & 609.

64 HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 5.2.2; HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*); HR 5 June 2009, ECLI:NL:HR:2009:BH2822 (*Stichting GeSp v. Aegon Bank*).

65 HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank v. Everaars*), para. 3.3; HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen v. Rabobank*), para. 3.6.4.

66 More in general: T.F.E. TJONG TJIN TAI, *Zorgplichten en zorgethiek*, Amsterdam 2006, p 2.

67 In more detail: W.H.F.M. CORTENRAAD, ‘Hoe bijzonder is de bijzondere zorgplicht?’, *Ondernemingsrecht* 2012(128); A.C.W. PIJLS, ‘De bijzondere zorgplicht van de financiële dienstverlener’, in F.G.M. Smeele & M.A. Verbrugh (eds), ‘*Opgelegde bescherming*’ in *het bedrijfsrecht* (Den Haag: BJu 2010).

68 See opinion of Advocate General J.B.M.M. Wuisman for HR 13 May 2011, ECLI:NL:PHR:2011:BP6921 (*X v. SNS Securities*), para. 2.12; conclusion Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 13 October 2014, ECLI:NL:PHR:2014:674 (*ING v. Keijzer c.s.*), para. 17; conclusion Attorney General M.H. Wissink ECLI:NL:PHR:2015:1975 (*ABN Amro/SBGB*), para. 5.3. See in more detail: M.W. WALLINGA, *WPNR* 2016.

interaction between these rules and the special duty of care of investment firms.<sup>69</sup> This interplay was considered by the *Hoge Raad* in its seminal securities leasing judgments. Relevant for present purposes is that the defendant banks submitted that as they had complied with the applicable standards laid down in the financial supervision framework, they had discharged the duties imposed on them in private law. The banks argued that they could not be held liable on the basis of private law for the breach of further-reaching private law standards. The *Hoge Raad* rejected this line of reasoning and followed the opinion on the issue that was provided by the Deputy Procurator General De Vries Lentsch-Kostense. She considered that the Dutch legal system is characterized by a double system of duties of care and that while regulatory conduct of business rules can influence the private law duty of care, they are not delineative of its scope.<sup>70</sup>

25. The *Hoge Raad* seems to have recently confirmed its view on the issue in a case revolving around the liability of a bank in relation to the provision of credit,<sup>71</sup> thereby indicating it has adopted this as a more general approach to the interaction between conduct of business rules contained in the financial supervision framework and private law duties of care. Under the approach adopted by the *Hoge Raad*, the special duty of care can thus indeed require a more far-reaching level of care in private law than the conduct of business rules contained in the financial supervision framework. In other words, the conduct of business rules do not eclipse, in the sense that they are exhaustive of, the standard of care owed in private law.<sup>72</sup>

26. At the same time, the conduct of business rules as transposed by MiFID and MiFID II can impact on liability for breach of an unwritten duty of care due to the fact that these rules function as relevant guidelines when establishing the scope of the special duty of care.<sup>73</sup> Retail investors can, therefore, invoke a breach of the MiFID and MiFID II conduct of business rules to substantiate the claim that by failing to comply with the special duty of care incurred by the firm, the latter acted

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69 In more detail: M.W. WALLINGA, *NTBR* 2014; W.H.F.M. CORTENRAAD, *Ondernemingsrecht* 2012, p 5; O.O. CHEREDNYCHENKO, ‘De bijzondere zorgplicht van de bank in het spanningsveld tussen publiek- en privaatrecht’, *NTBR* 2010(11).

70 Conclusion of the Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), no. 3.21.

71 HR 16 June 2017, ECLI:NL:HR:2017:1107 (*SNS v. Stichting Gedupeerden Overwaardeconstructie W&P*), see in particular para. 4.2.5.

72 See also in this regard: opinion of Advocate General M.H. Wissink ECLI:NL:PHR:2017:890, no. 3.14.

73 *Dexia/De Treek*, paras 4.10.3 & 4.11.5; opinion of Deputy Procurator General De Vries Lentsch-Kostense ECLI:NL:PHR:2009:BH2815, no. 3.21. In more detail about this and including further references: M.W. WALLINGA, *NTBR* 2014; O.O. CHEREDNYCHENKO, *NTBR* 2010. See also for instance: HR 8 February 2013, ECLI:NL:HR:2013:BY4440 (*Daelmans v. Dexia*), para. 3.6.2; HR 3 February 2012, ECLI:NL:HR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para 3.4.

in breach of, for example, an investment advisory contract with the investor. Accordingly, a breach of the conduct of business rules as transposed in the financial supervision framework provides retail investors with a cause of action based on Dutch contractual and non-contractual liability.

### 3.3. *England & Wales*

#### 3.3.1. *Importance of Judicial Enforcement Through Private Law Means in English Law*

27. Before considering the impact of the MiFID and MiFID II conduct of business rules on liability to pay damages in English law, it should be noted that the overall importance of judicial enforcement through private law means is limited in English law. This is due to the fact that many (retail) investment disputes are resolved by the Financial Ombudsman Service (hereafter: the ‘FOS’) and that the Financial Conduct Authority can secure consumer redress on a wider scale.<sup>74</sup> In particular, the FOS tends to resolve a significant number of retail investment disputes by offering an inexpensive and less formalistic alternative to long and expensive legal proceedings. Nevertheless, a retail investor could still prefer to pursue an action for damages in common law. The most obvious one is that the retail investor is dissatisfied with the determination on his complaint made by the FOS. Although such a determination is binding on the regulated investment firm, the investor has the choice to reject it.<sup>75</sup> In addition, the retail investor will have to resort to other means of compensation to fully recover his losses when the investment loss suffered exceeds the compensation limit of £150,000 which the FOS can award.<sup>76</sup> Currently, the FOS is conducting research into whether the limit should be increased to £350,000,<sup>77</sup> which ties in

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74 See in further detail: G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products* (Oxford: OUP 2014), no. 12.34. It has been suggested that though there is little formal use by the FCA of its compensation powers, it can function as an instrument of pressure in negotiating settlements, see I.G. MACNEIL, *An Introduction to the Law on Financial Investments* (Oxford & Portland: Hart Publishing 2012), p 101, fn. 153. The FCA itself has also indicated that it expects to deploy these powers on ‘rare occasions only’, see the EG 11.1.2 of the Enforcement Guide of its handbook. The first time the FCA exercised its power to require a company to award restitution to investors was in relation to market abuse by Tesco, see <https://www.fca.org.uk/news/press-releases/tesco-pay-redress-market-abuse> (accessed 14 April 2019) I thank Professor Paul Davies for this insight.

75 See also on this: E.P. ELLINGER, E. LOMNICKA & C.V.M. HARE, *Ellinger’s Modern Banking Law* (Oxford: OUP 2011), p 48.

76 In the light of the compensation limit of the FOS of £150.000, judicial enforcement will generally be a matter for high net worth individuals who have the resources to make investments that are capable of yielding such a loss, see K. STANTON, ‘Investment advice: The statutory remedy’, *PN (Professional Negligence)* 2017(2), p 156.

77 FCA, ‘Increasing the award limit for the Financial Ombudsman Service’, CP18/31.

with the extension of the access to the FOS for small and medium-sized enterprises.<sup>78</sup>

### 3.3.2. *Duty to Exercise Reasonable Care and Skill*

28. Liability for breach of an unwritten duty of care could allow investors to invoke the MiFID and MiFID II conduct of business rules to claim damages in English law. English law is characterized by the absence of an overarching duty of good faith in both negotiations and performance of contracts.<sup>79</sup> As such, retail investors are unable to take recourse to a breach of such a principle, which, as a general clause, might otherwise offer a gateway to the effect of EU investor protection regulation in claiming damages from an investment firm. Nevertheless, English law has developed, in certain relationships, piecemeal solutions that mitigate the absence of a principle of good faith.

In the absence of an express term providing for the manner in which the investment firm is to conduct its business, the firm, as is the case with professionals or otherwise skilled parties,<sup>80</sup> will be under an implied duty to exercise reasonable care and skill in rendering the investment service due from it under the contract with a retail investor.<sup>81</sup> The duty to exercise reasonable care and skill is not restricted to contract. Tort law can impose an identical duty when providing investment services.<sup>82</sup> In the investment advisory

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78 FCA, ‘SME access to the Financial Ombudsman Service – near-final rules’, PS18/21.

79 See in general and including further references: G. McMEEL, *The Construction of Contracts: Interpretation, Implication, and Rectification* (Oxford: OUP 2017), no. 1.67. Often cited in this regard is Lord Ackner’s description in *Walford v. Miles* [1992] 2 A.C. 128 of the concept of good faith as ‘inherently repugnant to the adversarial position of the parties when involved in negotiations’.

80 *Greaves & Co (Contractors) Ltd v. Baynham Meikle & Partners* (1975) 119 S.J. 372 CA (Civ Div), per Lord Denning, pp 103 & 104. See about this in further detail: J.L. POWELL & R. STEWART (eds), *Jackson & Powell on Professional Liability* (London: Sweet & Maxwell 2017), no. 2.002 et seq.; C.T. WALTON et al. (eds), *Charlesworth & Percy on Negligence* (London: Sweet & Maxwell 2014), no. 9.15.

81 R. CRANSTON, *Principles of Banking Law* (Oxford: OUP 2018), pp 271 et seq.; J.L. POWELL & R. STEWART, *Jackson & Powell on Professional Liability*, no. 15.022, who also point out that the duty is implied at common law under the Consumer Rights Act 2015, s. 49 & the Supply of Goods and Services Act, s. 13; R. HOOLEY, ‘Banking’, in A. Burrows (ed.), *English Private Law* (Oxford: OUP 2013), no. 14.40.

82 *O’Hare v. Coutts & Co.* [2016] EWHC 2224 (QB), per Kerr J, pp 199 & 207; implicitly *Rubenstein v. HSBC Bank* [2011] EWHC 2304, as per HHJ Havelock-Allan QC, p 87; [2012] EWCA Civ 1184, as per Rix LJ, p 46; *Henderson v. Merrett Syndicates Ltd* [1995] 2 A.C. 145, in which it was held that there was a duty in an advisory relationship to exercise reasonable care and skill concurrent in contract and tort. See also about this duty being based on both contract and tort when providing advice: R. CRANSTON, *Principles of Banking Law*, p 272; K. STANTON, *PN* 2017, p 155.

relationship, for instance, this duty, therefore, runs through contract and tort (of negligence).<sup>83</sup>

### 3.3.3. *Contractual Estoppel*

29. It is important to note that as a result of the doctrine of contractual estoppel, firms are able to draft contracts with investors in such a way so as to preclude the coming into existence of an investment services relationship.<sup>84</sup> The reluctance of English civil courts to override contractual arrangements has given rise to cases where, though a firm provided an investment service, the investor was excluded from claiming compensation of losses suffered as a result of a breach of duty in relation to that service.

30. The authorities on the issue demonstrate that parties can contractually agree the basis on which they enter into a relationship and that their dealings shall be conducted on a specific basis of fact, whereby through the doctrine of contractual estoppel parties are barred from denying to the contrary.<sup>85</sup> The terms of the agreement that define the basis of the relationship between an investment firm and an investor can, for example, contain so-called no responsibility or non-reliance clauses or clauses that disclaim that advice has been given or exclude that any duty of care arises.<sup>86</sup> The doctrine of contractual estoppel can then preclude the investor from alleging that advice was, in fact, given and that a duty to advise with reasonable care and skill arose or that he relied on the advice provided. Contractual estoppel thereby permits defensively drafted contracts to prevent the coming into existence of a duty to exercise reasonable care and skill that otherwise, on the actual facts, would have arisen.<sup>87</sup>

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83 R. CRANSTON, *Principles of Banking Law*, p 186.

84 See about this in more detail: J. BRAITHWAITE, 'Springwell-watch: New Insights Into the Nature of Contractual Estoppel', *LSE WP* 2017(12); G. McMEEL, 'The Impact of Exemption Clauses and Disclaimers: Construction, Contractual Estoppel and Public Policy', in A. Dyson, J. Goudkamp & F. Wilmot-Smith, *Defences in Contract* (Oxford: Hart Publishing 2017); J. BRAITHWAITE, 'The origins and implications of contractual estoppel', *L.Q.R. (Law Quarterly Review)* 2016(1); K. ALEXANDER, 'England and Wales', in D. Busch & C.C. van Dam (eds), *A Bank's Duty of Care* (Oxford and Portland: Hart Publishing 2017), p 250; P. MARSHALL, 'Humpty Dumpty is broken: 'unsuitable' and 'inappropriate' swaps transactions', *JIBFL* 2014(11), p 679; P. REYNOLDS, 'Selling financial products: the interface between regulatory and common law standards', *JIBL&R (Journal of International Banking Law and Regulation)* 2014(5), p 273.

85 *Raiffeisen*, as per Clarke J, p 250; *Thornbridge*, as per Moulder HHJ, p 111.

86 See for an overview of the widely adopted types of provisions in this regard: J. BRAITHWAITE, *L.Q.R.* 2016, pp 135 et seq.

87 See for an example: *Crestsign* [2014] EWHC 3043 (Ch), as per Kerr QC, p 111; *Springwell* [2008] EWHC 1186, as per Gloster J, pp 482 & 556. See also G. McMEEL, in *Defences in Contract*, p 241; P. MARSHALL, *JIBFL* 2014, p 680; R. HOOLEY, in *English Private Law*, no. 14.40.

31. The doctrine of contractual estoppel is grounded in the principle of freedom of contract and aims to protect party autonomy to define the nature and factual basis of contractual relationships, with the core justification being legal certainty.<sup>88</sup> The authorities available have been interpreted as representing a policy choice made by English courts to favour legal certainty over contextual considerations.<sup>89</sup> In any case, contractual estoppel has proved to raise an extremely difficult hurdle for sophisticated parties to clear in order to successfully claim damages from an investment firm in relation to the provision of investment services.<sup>90</sup> Investment firms have regularly deployed contractual estoppel as a successful defence in disputes with sophisticated entities in relation to investments in complex financial products to hedge risks, such as swaps, or to make speculative investments.<sup>91</sup> Though it would appear to play a more significant role in relation to sophisticated counterparties,<sup>92</sup> the issue of contractual estoppel has also been raised in disputes over mis-selling with smaller corporate clients and retail consumers.<sup>93</sup>

32. Contractual estoppel can, therefore, play a significant role in the area of investment services. Under the principle of freedom of contract, firms are able to draft the terms of the contract with a retail investor in relation to the provision of investment services in such a way as to effectively limit the access of retail investors to compensation. This goes to show that the importance that English courts attach to freedom of contract and protecting party autonomy can result in a limitation of the degree of protection investors can effectively derive from English law. This should, however, not be understood as that English courts would, in general, be unwilling to allow for MiFID and MiFID II conduct of business rules to interact with the duty of care required at common law.

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88 See specifically Moore-Bick LJ in *Globe Motors Inc v. TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396, p 119. Similarly in *Springwell* [2010] EWCA Civ 1221, p 143. See also about this including further references: J. BRAITHWAITE, *LSE WP* 2017, pp 11 & 29; G. McMEEL, in *Defences in Contract*, pp 239 & 240; J. BRAITHWAITE, *L.Q.R.* 2016, p 130; G. McMEEL, *The Construction of Contracts* (edn 2011), no. 26.63.

89 P. MARSHALL, *JIBFL* 2014, p 682. See also more in general in this regard: G. McMEEL, *The Construction of Contracts*, no. 26.71.

90 *Dubai Islamic Finance v. PSI Energy Holding Company* [2013] EWHC 3781 (Comm).

91 In more detail and including further references: J. BRAITHWAITE, *LSE WP* 2017, p 2; G. McMEEL, in *Defences in Contract*, p 240; J. BRAITHWAITE, *L.Q.R.* 2016, pp 120 & 132; R. HOOLEY, in *English Private Law*, no. 14.40.

92 J. BRAITHWAITE, *L.Q.R.* 2016, p 147.

93 *Crestsign* [2015] EWCA 986; *Thornbridge* [2015] EWHC 3430. See also J. BRAITHWAITE, *LSE WP* 2017, pp 9 et seq., who also demonstrates that the doctrine of contractual estoppel is applied outside the investment context in cases involving non-financial contracts.

### 3.3.4. *Interplay with Regulatory Conduct of Business Rules*

33. As was shown, provided the specific contract between the parties does not contain a basic clause to the contrary, the investment firm will be under an implied, if not express, duty to exercise reasonable care and skill when providing investment services to retail investors. Case law suggests that English courts, in general, embrace the principle that conduct of business rules inform the duty to exercise reasonable care and skill. This can allow retail investors to indirectly invoke the conduct of business rules in bringing a claim for damages.

34. *Gorham & Others v. British Telecommunications Limited plc* is the first leading case in which the interface between common law standards and financial regulation was considered.<sup>94</sup> The case revolves around the alleged unsuitability of advice provided to a policyholder to join a personal pension plan instead of an occupational pension scheme. Had the policyholder entered the occupational pension scheme, his dependant family would have been entitled to a lump sum death benefit payable under the scheme. The pension provider contended that the applicable regulatory standards, which at the time were the Conduct of Business Rules formulated by then regulator LAUTRO under the Financial Services Act 1986, determined the scope of duty at common law and that because it had not breached any of the standards contained in the regulatory framework, there could be no liability. The pension provider advanced, in other words, that there was no room for requirements at common law other than and beyond the rules provided for by the FSA 1986 and the standards made by the regulator under the then applicable framework of financial conduct regulation. The Court of Appeal rejected this view. As per Pill LJ:

Mr Palmer [for the claimants, MWW] rightly accepts the pressing need which developed in the 1980s for a statutory framework within which financial services could be provided. *I do not however discern a Parliamentary intention to eliminate the power of courts to decide whether a duty of care arises in a particular situation and, if so, what its extent is.* Had Parliament not intervened, remedies for the abuses which existed in this field would almost certainly have been developed by the courts. The courts now do so in the context, and with the benefit of, rules and codes of practice laid down by those concerned with the maintenance of proper standards. The courts can be expected to *attach considerable weight* to the content of codes drafted in these circumstances but are not excluded from making their own assessment of a situation.<sup>95</sup>

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94 [2000] EWCA Civ 234.

95 *Ibid.* (my italics).



35. The decision underlines the freedom of civil courts to decide on the common law standard of conduct.<sup>96</sup> The extent of care required in common law from firms is, therefore, not limited to the applicable regulatory requirements. That the conduct of business standards contained in the financial supervision framework are not considered determinative of the common law duty of care is not to say that these regulatory conduct of business rules are of no relevance in this regard. The Court acknowledged that ‘considerable weight’ should be attached to the content of regulatory requirements, and thus that conduct of business rules are to assist in establishing the content of the duty to exercise reasonable care and skill. That the relevant test to determine the standard of care required from an investment firm under common law includes consideration of financial conduct regulation has been confirmed in subsequent case law.<sup>97</sup> More recently, the interplay between conduct of business rules and the common law duty to exercise reasonable care and skill was considered in *O’Hare v. Coutts & Co.*<sup>98</sup> Building on authorities previously discussed, Kerr J held that:

( ... ) the regulatory regime is *strong evidence* of what the common law requires; since “the skill and care to be expected of a financial adviser *would ordinarily include* compliance with the rules of the relevant regulator ( ... ).<sup>99</sup>

36. The court expanded on this when finding the content of the information disclosure duty at common law in the situation where relevant regulatory conduct of business rules apply. According to Kerr J:

Compliance with them [the relevant standards contained in financial conduct regulation, MWW] is *ordinarily enough to comply* with a common law duty to inform, forming part of the duty to exercise reasonable skill and care; while breach of them will ordinarily also amount to a breach of that common law duty.<sup>100</sup>

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96 In this regard: K. STANTON, *PN* 2017, p 170; A.S. HUDSON, *The Law and Regulation of Finance* (London: Sweet & Maxwell 2013), no. 3.30.

97 *Rubenstein v. HSBC Bank plc* [2011] EWHC 2304 QB; *Loosemore v. Financial Concepts (a firm)* [2001] Lloyd’s Rep PN 235; *Seymour v. Caroline Ockwell & Co* [2005] EWHC 1137 (QB); *Shore v. Sedgwick* [2007] 2509 (QB); *Green & Rowley v. RBS* [2013] EWCA Civ 1197 appeared, at first glance, to provide a new strand to the authorities on the interplay between financial conduct regulation and the duty of care at common law. However, while the door was shut rather firmly to the line of reasoning that breach of financial conduct regulation gives rise to a direct cause of action at common law, it was left ajar for regulatory requirements to inform the normative content of the common law duty of care. Similarly: P. REYNOLDS, *JIBL&R* 2014, p 272.

98 [2016] EWHC 2224 (QB).

99 *Ibid.*, p 207 (my italics).

100 *Ibid.*, p 208 (my italics).

37. The available case law on the interplay between investor protection regulation and the common law duties of care shows that English courts, in general, view the applicable conduct of business rules contained in the financial supervision framework as highly relevant in determining the scope of the duty to exercise reasonable care and skill.<sup>101</sup> The courts, in other words, appear to embrace the principle that regulatory conduct of business rules can inform a duty of care at common law and tend to interpret such a duty of care in line with these rules.<sup>102</sup> Due to the fact that a firm's breach of a regulatory conduct of business rule provides *prima facie* evidence for the failure by that firm to exercise reasonable care and skill,<sup>103</sup> the retail investor can, in principle, invoke the MiFID and MiFID II conduct of business rules to substantiate a claim for damages based on common law.

38. The majority of the relevant authorities revolve around disputes in relation to the provision of (allegedly unsuitable) investment advice. Considering the justification for the approach developed in these decisions, it appears that the impact of conduct of business rules on common law duties of care is, however, not restricted to the investment advisory relationship. As Kerr J put it in *Crestsign* and *O'Hare*, the regulatory requirements afford strong evidence as to what is required under common law due to the fact that the skill and care to be expected of an adviser will ordinarily include compliance with the applicable conduct of business rules made by the regulator.<sup>104</sup> Put differently, the conduct of business rules contained in financial regulation should be considered when establishing the required level of care under common law on account of the fact that investors are reasonably entitled to expect that the regulated firm they are in a regulated relationship with will comply with the applicable financial supervision framework.<sup>105</sup> The approach developed by the courts to the interplay between regulatory rules and common

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101 It has been proposed that this probably does not include the more general Principles for Businesses set out by the FCA in the High Level Standards section of its Handbook. See in more detail: G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products*, no. 5.07; P. REYNOLDS, *JIBL&R* 2014, p 273; J. RUSSEN, *Financial Services. Authorisation, Supervision, and Enforcement: A Litigator's Guide* (Oxford: OUP 2006), no. 5.19.

102 Similarly: G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products*, no. 11.20; Law Commission, *Fiduciary Duties of Investment Intermediaries*, Law Commission Consultation Paper No. 215 (London: 2013), paras 11.18 et seq.

103 See in this regard: G. MITCHELL, 'To advise or not to advise?', *JIBFL* 2014(11), p 686; A.S. HUDSON, *The Law and Regulation of Finance*, no. 3.27, referring to *Cowan de Groot Properties v. Eagle Trust* [1992] 4 All E.R. 700.

104 *O'Hare v. Coutts & Co* [2016] EWHC, p 207; *Crestsign v. NatWest & RBS* [2014] EWHC 3043 (Ch), p 127; *Green & Rowley v. RBS* [2014] EWHC 3043 (Ch), p 18; *Loosemore v. Financial Concepts (a firm)* [2001] Lloyd's Rep PN 235, at 241-242.

105 In this regard: *Brandeis (Brokers) v. Herbert Black & Others* [2001] 2 All E.R. (Comm) 980, as per Toulson J, p 20. See also P. MARSHALL, 'Interest rate swaps and the sale of the unknown: blind alleys, an enfeebled equity and the triumph of certainty over fairness', *JIBFL* 2014(9), p 11. In a similar vein: K. STANTON, *PN* 2017, p 171, who justifies the influence of financial conduct

law duties of care thus appears to extend to other relationships where the conduct of a regulated party is governed by a financial supervision regime.

### 3.4. Germany

#### 3.4.1. Contractual Liability

39. In contrast to Dutch and English law, liability for breach of an unwritten duty of care in German law is restricted to liability in contract. Contractual liability is the primary cause of action in German law for retail investors to claim compensation for suffered investment losses.

#### 3.4.2. The Duty of Care Formulated in *Bond*

40. The starting point of the analysis of the approach of German civil courts to liability for breach of an unwritten duty of care is the seminal *Bond* decision.<sup>106</sup> The case revolves around the bonds issued by an Australian company, Bond-Finance Ltd. The claimants purchased these bonds based on their bank's advice, using money that had become available after a savings contract came to maturity. Prior to the conversation in which the investment was recommended, the Australian Rating Agency had lowered the credit rating of the bonds from 'BB' to 'CCC', signifying a real risk the issuing company would become insolvent. Ultimately, the bonds had become virtually worthless. The claimants brought an action for compensation of suffered losses complaining that the bank had denied the existence of risk regarding the bonds. The *Bundesgerichtshof*, the German Federal Court of Justice (hereafter: the '*BGH*'), granted the claim for compensation on the grounds that the bank had acted in breach of duties derived from an (implied) investment advisory contract.<sup>107</sup> In its decision, the *BGH* formulated an elaborate catalogue of investor protection-oriented private law duties of care, which it has refined over the years in subsequent case law. The over-arching obligation, for example in the context of the provision of investment advice, imposed on firms is to provide correct and complete investment advice in order to support a (retail) investor in making his investment decision.<sup>108</sup>

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regulation on what constitutes a failure of reasonable care and skill on the basis of the fact that a reasonable person obeys the law.

106 BGH 6 July 1993, *XI ZR 12/93*, (*Bond*), *NJW* 1993, p 2433.

107 The construction of an investment advisory contract, which parties would have tacitly agreed on and thus entered into with the investor approaching the investment firm regarding the advice about the investment of a sum of money, as the basis for the duties formulated by the BGH is not uncontested. A detailed analysis of this issue would go beyond the scope of this article.

108 BGH 6 July 1993, *XI ZR 12/93* (*Bond*), *NJW* 1993, p 2434 ('*Pflicht zur richtigen und vollständigen Anlageberatung*'), confirmed in: BGH 20 June 2015, *XI ZR 316/13*, *NJW* 2015, p 1095, no. 16;

The general duty to provide correct and complete investment advice breaks down into two more specific duties which show considerable overlap with the suitability rule and information disclosure duty laid down in the financial supervision framework.<sup>109</sup> First, investment firms need to tailor the recommendation of an investment to the personal characteristics of the investor (*‘anlegergerechte Beratung’*).<sup>110</sup> In general, investment firms are required to acquire information from the investor about his or her knowledge about the intended type of investment and willingness to take risks as well as whether it concerns an experienced investor with relevant expertise and what investment objectives he or she pursues.<sup>111</sup> Second, firms need to tailor the advice to the nature and risks of the intended investment that are, or could be, of essential importance to the investor’s decision in a manner that is geared towards the specific investment object (*‘objektgerechte Beratung’*), which includes the duty to disclose information about the investment and to examine its characteristics.<sup>112</sup>

41. Violation of these investor protection-oriented duties formulated in the case law of the *BGH* by an investment firm can give rise to breach of duty for the purposes of contractual liability.<sup>113</sup> The MiFID and MiFID II conduct of business rules might be used in satisfying the condition of breach of duty to establish contractual liability. While (retail) investors can already make use of the catalogue

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BGH 27 September 2011, *XI ZR 182/10*, *NJW* 2012, p 66, no. 22; BGH 22 March 2011, *XI ZR 33/10*, *NJW* 2011, p 1949.

109 In this regard: A. FUCHS, in A. Fuchs (ed.), *Wertpapierhandelsgesetz Kommentar* (München: C.H. Beck Verlag 2016), Vorbemerkung § 31, no. 80.

110 BGH 6 July 1993, *XI ZR 12/93 (Bond)*, *NJW* 1993, p 2433, confirmed in: BGH 22 March 2011, *XI ZR 33/10*, *NJW* 2011, p 1949, no. 24 (specifically with regard to the investment goals of the investor and the investor’s appetite for risk). See also S. GRUNDMANN, ‘Wertpapierhandelsgesetz (mit flankierenden Verordnungen)’, in S. Grundmann, J.-H. Binder & F. Möslin (eds), *Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2* (Berlin: De Gruyter 2018), no. 203; G. NOBBE & K. Zahrte, ‘Anlageberatung’, in W. Hadding et al. (eds), *Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen* (München: C.H. Beck 2014), no. 86 et seq.; M. HANNÖVER, ‘Beratungs- und Informationspflichten im Effektengeschäft’, in H. Schimansky, H.-J. Bunte & H.-J. Lwowski (eds), *Bankrechts-Handbuch* (München: C.H. Beck 2011), no. 51 et seq.; F. Braun, V. Lang & A. Loy, ‘Anleger- und anlegergerechte Beratung’, in J. Ellenberger et al. (eds), *Praktikerhandbuch Wertpapier- und Derivategeschäft* (Heidelberg: Finanz Colloquium 2011), no. 302 et seq.

111 BGH 6 July 1993, *XI ZR 12/93 (Bond)*, *NJW* 1993, p 2433.

112 BGH 6 July 1993, *XI ZR 12/93 (Bond)*, *NJW* 1993, p 2443. See also S. GRUNDMANN, in *Staub Handelsgesetzbuch Großkommentar*, no. 203; G. SPINDLER, in *Bankrechts-Kommentar*, no. 123; G. NOBBE & K. Zahrte, in *Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen*, no. 131 et seq.; M. HANNÖVER, in *Bankrechts-Handbuch*, no. 55 et seq.; F. Braun, V. Lang & A. Loy, in *Praktikerhandbuch Wertpapier- und Derivategeschäft*, no. 305 et seq.

113 § 280 BGB.

of private law duties formulated (primarily) in the case law of the *BGH* to claim damages, the regulatory conduct of business rules on account of prescribing in detail what conduct can be required from an investment firm could, potentially, still benefit investors in developing a claim for compensation of investment losses.<sup>114</sup>

### 3.4.3. *Interplay with Regulatory Conduct of Business Rules*

42. The *BGH* initially took a rather careful approach to the potential influence of conduct of business rules contained in the financial supervision framework on the normative content of (pre)contractual duties.<sup>115</sup> Earlier case law suggested that the conduct of business rules could have an indirect or radiating effect on the standard of care required in private law.<sup>116</sup> Under this ‘*Ausstrahlungswirkung*’,<sup>117</sup> the conduct of business rules are given consideration when determining the existence and scope of particular duties of care that can be derived from abstract private law standards and general clauses.<sup>118</sup> The MiFID and MiFID II conduct of business

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114 The manner in which retail investors can invoke the regulatory conduct of business rules contained in the framework of financial supervision relates, to a large extent, to their nature. A detailed analysis of this issue would go beyond the scope of this article. While there seems to be an increasing number of authors who hold that the conduct of business rules (also) specify contractual, or at least precontractual, duties for firms when providing investment services in light of MiFID II’s stronger focus on investor protection, the school of thought, with which the Eleventh Panel of the *BGH* has sided, that regards the conduct of business rules to be public law in nature seems to represent the prevailing opinion, at least in German practice. See for more information and further references: M.W. WALLINGA, *EU Investor Protection Regulation and Private Law. A Comparative Analysis of the Interplay Between MiFID & MiFID II and Liability for Investment Losses* (forth. 2019), s.4.7.2; S. GRUNDMANN, in *Staub Handelsgesetzbuch Großkommentar*, no. 126 & 224.

115 P. BUCK-HEEB, ‘Die „Flucht“ aus dem Anlageberatungsvertrag’, *ZIP* 2013(30), p 1410.

116 *BGH* 8 May 2001, *XI ZR 192/00*, *NJW* 2002, p 62; *BGH* 5 October 1999, *XI ZR 296/98*, *NJW* 2000, p 359, no. 32; *BGH* 19 December 2006, *XI ZR 56/05*, *NJW* 2007, p 1876, no. 18, confirmed in: *BGH* 19 February 2008, *XI ZR 170/07*, *NJW* 2008, p 1734, no. 14.

117 What is exactly understood under ‘*Ausstrahlungswirkung*’ is, however, not entirely clear, see also H.-D. ASSMANN, ‘Das Verhältnis von Aufsichtsrecht und Zivilrecht im Kapitalmarktrecht’, in U. Burgard et al. (eds), *Festschrift für Uwe H. Schneider* (Köln: Dr. Otto Schmidt 2011), p 53, who labels the theory of *Ausstrahlungswirkung* as ‘*diffus*’. In the same vein: P. BUCK-HEEB, ‘Aufklärung über Innenprovisionen, unvermeidbarer Rechtsirrtum und die Überlagerung durch Aufsichtsrecht Zugleich Besprechung von *BGH* vom 3.6.2014 = *WM* 2014, 1382’, *WM (Wertpapier-Mitteilungen)* 2014(34), p 1604, who describes the ‘*Ausstrahlungswirkung*’ as ‘*dogmatisch nebulös*’.

118 Eloquently described by Koller as ‘*Transfer eines Rechtsgedankens*’, see I. KOLLER, in H.-D. Assmann & U.H. Schneider (eds), *Wertpapierhandelsgesetz Kommentar* (Köln: Dr. Otto Schmidt 2012), Vorbemerkung s. 31, no. 3, fn. 6. More in general about ‘*Ausstrahlungswirkung*’ in this context: G. SPINDLER, in *Bankrechts-Kommentar*, no. 28 et seq.; A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 80 et seq.; D. EINSELE, ‘Verhaltenspflichten im Bank und Kapitalmarktrecht – öffentliches Recht oder Privatrecht?’,

rules as transposed in the German financial supervision framework are thus relevant in determining the standard of care required from investment firms in contract law.

43. Moving away from its earlier case law, the *BGH* has taken a rather dismissive stance against the theory of ‘*Ausstrahlungswirkung*’, that is, the radiating or concretising effect of conduct of business rules on contractual liability.<sup>119</sup> A striking example of this is the *BGH*’s 2013 ruling,<sup>120</sup> which builds on its approach in two earlier judgments in 2011 which offer the first signs of this development.<sup>121</sup> The *BGH*’s 2013 ruling focuses on the acquisition of Lehman Brothers Treasury certificates on the basis of an investment recommendation made by a bank that subsequently sold the instrument to the litigating retail investor. The investor claimed damages from the bank for breach of the duty to disclose information about profit margins on sold financial instruments in the investment advisory relationship. The investor relied on breach of § 31d of the German Securities Trading Act (the ‘*Wertpapierhandelsgesetz*’, hereafter: the ‘WpHG’) as the basis for (pre)contractual liability. The provision contained in an older version of the financial supervision framework prohibits firms from offering or accepting inducements, understood as commissions, fees, and other payments. The *BGH* held that the regulatory rule by itself does not establish a (pre)contractual duty.<sup>122</sup> The Court reiterates earlier case law and holds that the conduct of business rules contained in German financial supervision law are exclusively public law in nature and by way of their very nature do not influence the obligation under § 280 BGB from which (pre)contractual duties arise.<sup>123</sup> Subsequently, the *BGH* turns to the potential ‘*Ausstrahlungswirkung*’ of Section 31d WpHG:

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*ZHR* 2016(02), pp 243 et seq.; G. NOBBE & K. ZAHRTKE, in *Münchener Kommentar zum Handelsgesetzbuch*, no. 62 et seq.; P. BUCK-HEEB, *WM* 2014, pp 1604 et seq.; J. FORSCHNER, *Wechselwirkungen von Aufsichtsrecht und Zivilrecht*, pp 113 et seq.; H.-D. ASSMANN, in *Festschrift für Uwe H. Schneider*, p 47; E. SCHWARK, in: E. SCHWARK & D. ZIMMER (eds), *Kapitalmarktsrecht-Kommentar* (München: C.H. Beck Verlag 2010), Vorbemerkung s. 31, no. 12 & 16 et seq.; J. ELLENBERGER, ‘MiFID FRUG: Was wird aus Bond’, in M. Habersack, H.-U. Joeres & A. Krämer (eds) *Festschrift für Gerd Nobbe* (Köln: RWS Verlag 2009), pp 534 et seq. Also using the formulation of ‘*Ausstrahlungswirkung*’: *BGH* 17 September 2013, *XI ZR* 332/12, no. 8, *WM* 2013, p 1983; *BGH* 8 May 2001, *XI ZR* 192/00, *NJW* 2002, p 62.

119 See also S. GRUNDMANN, ‘Privatrecht und Regulierung’, in H.C. Grigoleit & J. Petersen (eds), *Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag* (Berlin: De Gruyter 2017), p 933; D. KRISL, *Die Schutzgesetzeigenschaft der Wohlverhaltenspflichten nach den §§ 31 ff. WpHG* (doctoral thesis) (Hamburg: Verlag Dr. Kovač 2013), pp 51 et seq.

120 *BGH* 17 September 2013, *XI ZR* 332/12, *WM* 2013, p 1983.

121 *BGH* 27 September 2011, *XI ZR* 178/10, *NJW-RR* 2012, p 43 & *BGH* 27 September 2011, *XI ZR* 182/10, *NJW* 2012, p 66.

122 *BGH* 17 September 2013, *XI ZR* 332/12, *WM* 2013, p 1983, no. 15.

123 *BGH* 17 September 2013, *XI ZR* 332/12, *WM* 2013, p 1983, no. 16.



§ 31d WpHG can also not on the basis of a radiating effect establish an independent contractual obligation for the defendant to disclose information about the profits generated on an investment transaction. The public law conduct of business rules of § 31 WpHG et seq. could, insofar as they aim to provide investor protection, be of relevance for the content and scope of (pre)contractual information disclosure and advisory obligations. However, *their scope of protection in private law does not go beyond these (pre)contractual obligations*. Consequently, they have *no independent significance for liability that goes beyond that of the private law information disclosure and advisory obligations* ( ... ). The supervisory law conduct of business rules as such bring about neither a limitation nor expansion of the liability of investment advisers under private law ( ... ).<sup>124</sup>

44. The *BGH*'s decision, which it confirmed in 2014,<sup>125</sup> is interpreted in scholarly literature as a dismissal of the '*Ausstrahlungswirkung*' which conduct of business rules might have on contractual liability.<sup>126</sup> The decision, in other words, is seen as a rejection of the idea that regulatory conduct of business rules have a concretising, binding effect on the standard of care investment firms owe in contract law.<sup>127</sup> This is to say, that the conduct of business rules as transposed in the financial supervision framework do not provide the basis for an independent claim for damages in contractual liability, and cannot modify the duties of care in contract law.<sup>128</sup>

The rationale behind this could be that the *BGH* feared the loss of control over private law norm setting if a breach of regulatory conduct of business rules derived from EU law automatically establishes a breach of a (pre)contractual duty, giving rise to a cause of action on the basis of contractual liability under § 280 BGB.<sup>129</sup> Some question the merits of this fear, as the dominant understanding of '*Ausstrahlungswirkung*' appears not to attribute to it such a restriction on

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124 BGH 17 September 2013, XI ZR 332/12, no. 20, *WM* 2013, p 1983 (my translation and italics).

125 BGH 3 June 2014, XI ZR 147/12, *NJW* 2014, p 2947, no. 35.

126 In this sense: G. SPINDLER, in *Bankrechts-Kommentar*, no. 28b; M.P. LERCH, *Anlageberater als Finanzintermediäre. Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen* (doctoral thesis) (Tübingen: Mohr Siebeck 2015), p 171; P. BUCK-HEEB, *WM* 2014, p 1604; P. BUCK-HEEB, 'Anlageberatung nach der MiFID II', *ZBB* 2014(4), p 223; H.C. GRIGOLEIT, *ZHR* 2013, p 270.

127 A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 83a; G. SPINDLER, in *Bankrechts-Kommentar*, no. 28b; P. BUCK-HEEB, *ZBB* 2014, p 223.

128 G. SPINDLER, in *Bankrechts-Kommentar*, no. 28b; P. BUCK-HEEB, *ZBB* 2014, p 223.

129 P. BUCK-HEEB, *WM* 2014, p 1604. See also A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 83a.



autonomous private law norm setting.<sup>130</sup> The *BGH* might be going to relatively extreme lengths to curtail a specific, minority understanding of the indirect radiating or concretising effect of the conduct of business rules on contractual liability.

45. The *BGH* did, however, leave the door ajar for interaction between the conduct of business rules and private law duties of care, preventing the two systems from developing in complete isolation from each other.<sup>131</sup> The Court advanced, in its confirmatory judgment of 2014, a concept that can still allow retail investors to benefit from the detailed prescription by MiFID and MiFID II standards as to what conduct is required from investment firms in bringing an action in contractual liability. The Court held that the supervisory principle, according to which accepting inducements from third parties is allowed only when they are disclosed to the investor, gives rise to a general, nearly ‘comprehensive principle of law’ (*‘eines allgemeinen – nunmehr nahezu flächendeckenden – Rechtsprinzip’*) that should be taken into consideration in interpreting (implied) contractual declarations.<sup>132</sup> Investors, according to the *BGH*, may expect that firms, with which they are dealing, comply with such a fundamental principle. The approach adopted by the *BGH* might allow retail investors to invoke the MiFID and MiFID II conduct of business rules when bringing a claim for damages in contract. Retail investors could, for instance, substantiate the claim that there is general compliance by firms with the applicable MiFID and MiFID II information disclosure duty and suitability rule and that civil courts should, therefore, look at these rules when determining the existence and content of (pre)contractual duties of care.

## 4 Liability for Breach of a Statutory Duty: Direct Effect on Liability

### 4.1. General

46. Liability for breach of a statutory rule requiring certain conduct offers a gateway to a more ‘direct’ effect of the MiFID and MiFID II conduct of business rules on liability. The direct effect can be based on a mechanism that establishes non-contractual liability to pay damages for a breach of a statutory duty, which can enable investors to invoke the conduct of business rules more directly when bringing a claim for damages. After all, the conduct of business rules are generally transposed in statute in national legal systems. This direct manner of judicial

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130 A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 83a.

131 P. BALZER & V. LANG, ‘Zur Aufklärung über versteckte Innenprovisionen beim Anlageberatungsvertrag ab dem 1. 8. 2014’, *BKR (Zeitschrift für Bank- und Kapitalmarktrecht)* 2014(9), p 379; P. BUCK-HEEB, *WM* 2014, pp 1604 & 1605.

132 BGH 3 June 2014, *XI ZR 147/12*, *NJW* 2014, p 2947, no. 37. See also more in general: P. BUCK-HEEB & D. POELZIG, ‘Die Verhaltenspflichten (§§ 63 ff. WpHG n. F.) nach dem 2. FiMaNoG – Inhalt und Durchsetzung’, *BKR* 2017(485), pp 494 et seq. See also S. GRUNDMANN, in *Privatrechtsdogmatik im 21. Jahrhundert*, p 933.

enforcement of the conduct of business rules can contribute to retail investor protection because it does not depend on a duty of care implied in the contract or a general duty to act to provide the gateway to the effect of these rules on liability. While the Member States under investigation offer a mechanism of liability for breach of a statutory rule, the extent to which retail investors can resort to this mechanism in relation to the MiFID and MiFID II conduct of business rules differs in practice.

## **4.2. The Netherlands**

### *4.2.1. Underutilized Enforcement Mechanism*

47. Liability for breach of a statutory duty has been utilized relatively little by retail investors in Dutch law. This can be explained by the preference of retail investors to rely on a firm's breach of the (unwritten) special duty of care when claiming damages in the context of financial litigation (see in more detail: s. 3.2). Nevertheless, liability for breach of a statutory duty can provide retail investors with a more straightforward way of bringing an action for damages with regard to a breach of the MiFID and MiFID II conduct of business rules.

### *4.2.2. Interplay with Regulatory Conduct of Business Rules*

48. Breach of a statutory duty can give rise to an unlawful act for the purposes of establishing non-contractual liability in Dutch law.<sup>133</sup> Because such a statutory duty can be both private and public law in nature,<sup>134</sup> the retail investor can base a claim for damages directly on a breach of the conduct of business rules as transposed into the Dutch financial supervision framework. This should, however, not be understood in the sense that a breach of a conduct of business rule automatically leads to liability of firms to pay damages. The requirement of relativity can restrict the direct effect of these rules on non-contractual liability in Dutch law.

### *4.2.3. The Relativity Requirement*

49. Under the requirement of relativity (Art. 6:163 BW), a breach of a conduct of business rule will only establish liability of a firm to pay damages if the rule in question aims at protecting the (interests of the) claimant against the suffered damage and the way that damage has arisen. This means that not only the interests of the investor, but also the damage and the way in which that damage has arisen have to fall within the protective ambit of the conduct of business rule that serves as the basis for liability. The fact that a statutory provision requires a party to

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133 Art. 6:162(2) BW.

134 T.M., Parlementaire Geschiedenis Boek 6, p 615.

exhibit certain conduct does not *a priori* mean that it aims to protect the interests of a party that is claiming damages in relation to breach of that provision. In other words, the observation that the conduct of business rules as transposed into the financial supervision framework impose on firms certain standards of conduct does not, necessarily, mean that these rules aim to provide retail investors protection against the losses they claim compensation for and the manner in which those losses have arisen.

The *Hoge Raad* made it clear in *Nabbe v. Staalbankiers* that the requirement of relativity can prevent the imposition of liability to pay damages for breach of a statutory duty with regard to a breach of the MiFID and MiFID II conduct of business rules.<sup>135</sup> Nabbe brought an action for compensation against Staalbankiers for the losses he had suffered while trading in options. Nabbe claimed that Staalbankiers had acted in breach of the duty of care incurred by it by failing to comply with the margin requirement contained in the then applicable financial supervision framework.<sup>136</sup> The claim for damages was rejected. The *Hoge Raad* held that while the duty contained in the financial supervision framework did aim to protect the interests of a retail investor, it did not seek to protect the investor from every possible drop in share price and, therefore, not from the investment losses suffered by the investor.<sup>137</sup> If, on the facts of a specific case, the losses suffered by an investor can be considered as falling outside the ambit of a conduct of business rule that serves as the basis for non-contractual liability, the requirement can thus stand in the way of liability to pay damages.

50. It has been proposed in legal literature that the requirement of relativity should, as a general rule, not (be able to) stand in the way of a (successful) claim for damages in relation to a breach of the MiFID and MiFID II conduct of business rules.<sup>138</sup> This general line of reasoning appears to be at odds with the observation that judicial enforcement of the regulatory conduct of business rules through holding firms liable to pay damages based on private law falls outside of the harmonization scope of MiFID and the MiFID II (see s. 2.2). As a result, civil courts remain free to decide when the requirement of relativity, as a general private law norm that is used to establish the liability of firms to provide retail investors compensation for investment losses based on private law, is satisfied.

Furthermore, the line of reasoning is based on the assumption that if and when a claim for damages were to fail by virtue of the requirement of relativity, the effectiveness of MiFID (II) would be at jeopardy. However, Dutch law, in a general

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135 HR 4 December 2009, ECLI:NL:HR:2009:BJ7320 (*Nabbe v. Staalbankiers*).

136 Art. 29(2) Nadere Regeling toezicht effectenverkeer 1999. This duty is currently contained in Art. 86(1) Bgfo.

137 *Nabbe v. Staalbankiers*, para. 3.7.

138 D. BUSCH, *ERCL* 2017, p 86. In the same sense: D. BUSCH, 'De invloed van het Europees financieel toezichtrecht op het Nederlands privaatrecht', *WPNR* 2017(7175).

sense, could be considered to already contain mechanisms to ensure adequate retail investor protection underlying the directives by ensuring the proper functioning of administrative enforcement by national supervisory authorities and extrajudicial enforcement through available alternative dispute resolution bodies as prescribed by MiFID and MiFID II (see also s. 2.2).<sup>139</sup> In particular considering the level of specificity with which MiFID and MiFID II have tailored the power to take administrative sanctions and measures to breach of conduct of business rules,<sup>140</sup> the effective protection seems guaranteed by providing national supervisory authorities with the supervisory powers and sanctioning arsenal laid down by the directives.<sup>141</sup> After all, Member States are required by the effectiveness principle to make available in the national legal systems the remedies that ensure an adequate level of investor protection, not the highest level possible.<sup>142</sup>

Moreover, this line of reasoning overlooks the fact that rejection of an individual claim for damages by virtue of private law norms that determine whether a firm is liable to pay damages given the circumstances of the case does not automatically mean that national private law fails to provide adequate legal protection as required by the effectiveness principle.<sup>143</sup> A private law norm raises an obstacle serious enough to justify elimination under this principle if it, in a general sense, makes it virtually impossible or excessively difficult to claim damages in national contract or torts law for breach of the conduct of business rules. The fact that claims are not easily made ‘virtually impossible or excessively difficult’ for the purposes of the effectiveness principle emphasizes the considerable margin which the principle provides Member States and civil courts in shaping the response in private law liability to breach of MiFID and MiFID II conduct of business rules.<sup>144</sup>

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139 More in general: E. VANDENDRIESSCHE, *Investor Losses. A Comparative Legal Analysis of Causation and Assessment of Damages in Investor Litigation* (doctoral thesis) (Cambridge: Intersentia 2015), p 105.

140 Arts 50 & 51 MiFID; Arts 69 & 70 MiFID II.

141 In the same vein: H.C. GRIGOLEIT, *ZHR* 2013, pp 275 et seq. This could be supported by the fact that MiFID and MiFID II seem to regard administrative sanctions as effective, proportionate, and dissuasive (Art. 51 MiFID; Art. 70 MiFID II).

142 See in this regard: F. CAFAGGI & P. IAMICELI, ‘The Principles of Effectiveness, Proportionality, and Dissuasiveness in the Enforcement of EU Consumer Law: The Impact of a Triad on the Choice of Civil Remedies and Administrative Sanctions’, *ERPL* 2017(3), p 578; N. REICH, *General Principles of EU Civil Law* (Oxford: Intersentia 2013), p 92; W. VAN GERVEN, ‘Of Rights, Remedies and Procedures’, *CMLR (Common Markets Law Review)* 2000(3), p 503.

143 See also M.W. WALLINGA & A.C.W. PIJLS, *RMThemis* 2018, s. 2.2; M. HAENTJENS, *TPR* 2017, no. 61 et seq.; opinion of Advocate General L. Timmerman for HR 30 September 2016, ECLI:NL:PHR:163 (*FortisEffect e.a. v. Staat der Nederlanden*), no. 3.30; M.W. WALLINGA, *NTBR* 2014, s. 5.2.

144 More in general about the less demanding *Rewe* line and the room this offers Member States in shaping national law: S. PRECHAL, ‘Europeanisation of National Administrative Law’, in J. Jans, S. Prechal & R.J.G.M. Widdershoven, *Europeanisation of Public Law* (Groningen: Europa Law

51. What is more, though a civil court can reject a specific claim for damages on the particular circumstances of the case, investors could still benefit from an indirect effect of EU investor protection regulation on the requirement of relativity. Retail investors might be able to invoke the strong aim of investor protection that underlies MiFID and MiFID II to argue that their interests indeed fall within the protective scope of a specific conduct of business rule. Investors could similarly benefit from the protective aim of the conduct of business rules to argue that the suffered damage and the manner in which it has arisen fall within the protective scope of the rule(s) on which they wish to base a claim for damages in non-contractual liability. This relates to the specific manner in which the protective aim of particular conduct of business rules has been formulated. For instance, the information disclosure duty and the suitability rule aim to protect from losses resulting from not being able to make an independent, well-informed investment decision respectively losses arising out of unsuitable investment transactions. The protective aim of these MiFID and MiFID II conduct of business rules, thus, functions as an indication of the protective scope of the (implementation of the) regulatory conduct of business rules on which investors can ground an action for damages in non-contractual liability. The MiFID and MiFID II conduct of business rules can, therefore, have an effect on the assessment of the requirement of relativity allowing retail investors to more easily satisfy this requirement in relation to claims for damages for breach of the regulatory conduct of business rules.

### 4.3. *England & Wales*

#### 4.3.1. *Statutory Remedy*

52. Described as ‘one of the pillars of consumer protection’,<sup>145</sup> the UK financial supervision framework enables retail investors to bring a private action for compensation of losses for a breach of the regulatory regime (FSMA 2000, s. 138D(2), as amended by FSA 2012, formerly s. 150). The statutory remedy renders breach of the conduct of business rules made by the FCA actionable by conferring on private persons a cause of action against

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Publishing 2015), pp 58 et seq.; S. PRECHAL & R.J.G.M. WIDDERSHOVEN, ‘Redefining the Relationship between “Rewe-effectiveness” and Effective Judicial Protection’, *REAL (Review of European Administrative Law)* 2011(4), p 39. See for the general contextual test to assess the principle which also underlines the considerable margin of discretion: CJEU 14 December 1995, ECLI:EU:C:1994:437, C-312/93 (*Peterbroeck*); CJEU 14 December 1995, ECLI:EU:C:1994:441, joined cases C-430/93 and C-431/93 (*Van Schijndel*).

<sup>145</sup> K. STANTON, ‘Legislating for Economic Loss’, in T.T. Arvind & J. Steele (eds), *Tort Law and the Legislature. Common Law, Statute and the Dynamics of Legal Change* (Oxford and Portland: Hart Publishing 2013), p 270.

investment firms in the tort of breach of statutory duty. The category of private persons includes retail investors but excludes (also small) businesses.<sup>146</sup> The mechanism can be traced back to the FSA 1986, where it was adopted to supplement the regulatory and enforcement role of the regulator.<sup>147</sup> Though it appears that the mechanism was not widely used in its early days,<sup>148</sup> it played a role in resolving investor disputes with regard to the mis-selling of home income plans and personal pension plans.<sup>149</sup> It has been suggested that it is now routinely relied on in civil actions for damages in addition to the usual claims at common law.<sup>150</sup>

53. In order for a retail investor to be able to resort to the statutory remedy, the investor must show that the regulated investment firm in providing an investment service acted in breach of a provision that falls within the ambit of this remedy. This will generally be the case for the conduct of business rules that the FCA has laid down in the Conduct of Business Sourcebook, which includes the transposition of the MiFID and MiFID II conduct of business rules. Furthermore, the investor must establish that the damage he seeks to recover falls within the ambit of the statute. This requires that the damage suffered is of the kind which the statute intends to prevent and that the investor belongs to the category of persons which the statute intends to protect.<sup>151</sup> The retail investor, therefore, must show that he qualifies as a private person as expressed in FSMA 2000, s. 138D, which will usually be the case.<sup>152</sup>

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146 The Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, regulation 3, which states that ‘private person’ is meant to include any individual unless he suffers the loss in question in the course of carrying on any regulated activity. See in more detail about the definition of ‘private person’ and the unavailability, therefore, of the remedy for businesses: G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products*, no. 4.21; G. WALKER & R. PURVES (eds), *Financial Services Law* (Oxford: OUP 2014), no. 7.27.

147 K. STANTON, in *Tort Law and the Legislature*, pp 271 & 273.

148 E. FERRAN, ‘Dispute resolution mechanisms in the U.K. financial sector’, *C.J.Q.* 2002, p 150.

149 G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products*, no. 4.20.

150 Including a comprehensive list of cases in which the mechanism was pleaded: J.L. POWELL & R. STEWART, *Jackson & Powell on Professional Liability*, no. 14.082.

151 This calls to mind the requirement of relativity in Dutch law, in more detail: s. 4.2.3.

152 Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, regulation 3. See J. RUSSEN, *Financial Services*, no. 5.04. In more detail about the definition of ‘private person’ and the unavailability, therefore, of the remedy for businesses: G. McMEEL & J. VIRGO, *McMeel and Virgo on Financial Advice and Financial Products*, no. 4.21; G. WALKER & R. PURVES, *Financial Services Law*, no. 7.27. See also *Titan Steel Wheels Ltd v. RBS Plc* [2010] EWHC 211 (Comm), as per Steel J, pp 44 et seq. Recently about what he calls the mismatch between the English financial supervision framework and the MiFID and MiFID II definition of retail investors: G. McMEEL, in *Defences in Contract*, pp 254 & 255.

#### 4.3.2. *Interplay with Regulatory Conduct of Business Rules*

54. The approach to liability to pay damages on the basis of the statutory remedy suggests that it may be more favourable for retail investors to base a claim for compensation of investment losses on this mechanism than to bring a similar claim in contract or the tort of negligence. When claiming damages on the basis of these other categories of liability, investor protection regulation exacts an indirect influence on the standard of conduct required from the regulated investment firm at common law. As has been shown in more detail in section 3.3, the regulatory conduct of business rules ‘merely afford evidence’ as to what is required under the common law duty to exercise reasonable care and skill. The retail investor, consequently, still bears the burden of proof to establish that by breaching the regulatory conduct of business rule in question, the investment firm acted in breach of a duty necessary to establish contractual liability or the tort of negligence. Civil courts enjoy the freedom to decide that while the firm has acted in breach of a regulatory standard, it did not breach the duty to exercise reasonable care and skill when providing an investment service. The argument that the mere existence of a conduct of business rule gives rise to an equivalent, co-extensive duty at common law has been generally rejected in the available authorities.<sup>153</sup>

The statutory remedy, however, can provide retail investors with a direct cause of action for breach of the MiFID and MiFID II conduct of business rules by transforming financial conduct regulation laid down in the COBS section of the FCA Handbook into tortious duties. As these regulatory conduct of business rules prescribe in a detailed and specific manner what duties are imposed on an investment firm when providing investment services, the statutory remedy provides retail investors with a more straightforward way to establish liability.<sup>154</sup> The mechanism, therefore, has the potential to improve retail investor protection by providing an easier access to compensation.

55. An illustration of how the statutory remedy in relation to the MiFID and MiFID II conduct of business rules might benefit the retail investor relates to the regulatory rule for firms to explain both the nature of the recommended investment as well as the risks associated with the investment in sufficient detail to enable investors to take an investment decision on an informed basis.<sup>155</sup> The decision in *O’Hare v. Coutts & Co* might signify a departure from the *caveat emptor* approach

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153 See for instance: *Gorham & Others v. British Telecommunications Limited plc* [2000] EWCA Civ 234; *Seymour v. Caroline Ockwell & Co* [2005] EWHC 1137 (QB), p 77; *Green & Rowley v. RBS* [2013] EWCA Civ 1197, p 23. See also in this regard: G. WALKER & R. PURVES, *Financial Services Law*, no. 7.29; A.S. HUDSON, ‘The Synthesis of Public and Private in Finance Law’, in K. Barker & D. Jensen (eds), *Private Law: Key Encounters with Public Law* (Cambridge: CUP 2013), p 249.

154 See also K. STANTON, *PN* 2017, p 155; J.L. POWELL & R. STEWART, *Jackson & Powell on Professional Liability*, no. 14.082.

155 COBS 14.3.2R; COBS 14.3A.5EU.



to the provision of financial services more in general, and thus for common law to slowly converge with investor protection regulation as regards information disclosure.<sup>156</sup> However, it remains to be seen whether common law, as a general rule, will embrace the existence of a positive duty for investment firms to disclose material information and to ensure that retail investors understand both the advice provided and the risks related to a recommended investment. The statutory remedy allows the retail investor to point to the risk information disclosure duty laid down in the financial supervision framework to establish liability in tort without running the (same) risk of seeing his action dismissed on the ground that common law would not recognize the existence of an equivalent duty.

#### 4.3.2. *Contractual Estoppel*

56. Nevertheless, the access to the statutory remedy seems to be subject to the restrictions imposed by the doctrine of contractual estoppel as this doctrine appears to extend to the tort of breach of statutory duty (see in more detail about contractual estoppel: s. 3.3). A term disclaiming that an investment service is provided can thus allow an investment firm to plead contractual estoppel to exclude that the relationship it has entered into with the investor is one concerning the provision of investment services. This might, consequently, preclude the imposition on the firm of certain conduct of business rules specific to such a relationship for the purposes of establishing the tort of breach of statutory duty under the statutory remedy. However, a retail investor might nevertheless be able to use the statutory remedy to claim compensation on the basis of the tort of breach of statutory duty. This relates to the regulatory rule laid down in COBS 2.1.2R of the FCA's Handbook, which prohibits firms in the context of the provision of investment services to exclude or restrict, or rely on any exclusion or restriction of, any duty or liability it may have towards a client under the financial supervision framework. McMeel has suggested that when a firm contends, contrary to fact, that it did not provide investment services or invokes contractual estoppel to this effect, the firm acts in breach of this regulatory rule.<sup>157</sup> Accordingly, retail investors could bring an action for damages on the basis of the statutory remedy in the tort of breach of statutory duty.

### 4.4. *Germany*

#### 4.4.1. *Liability for Breach of a Statutory Protective Rule*

57. German non-contractual liability also offers a mechanism that can establish liability for breach of the MiFID and MiFID II conduct of business rules. Under

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156 [2016] EWHC 2224 (QB); [2017] 314 EWHC (QB). See also pointing in this direction *Crestsign v. NatWest & RBS* [2014] EWHC 3043.

157 G. McMEEL, in *Defences in Contract*, p 257.

§ 823 II BGB, claimants can bring an action for compensation in relation to a breach of what can be described as statutory protective rules (in German: ‘*Schutzgesetze*’). Whether the regulatory conduct of business rules contained in the financial supervision framework can qualify as statutory protective rules and, consequently, retail investors can more directly invoke these rules to bring a claim for damages under § 823 II BGB is the subject of intense, on-going discussion.

#### 4.4.3. *Qualification as a Statutory Protective Rule*

58. First of all, to qualify as a *Schutzgesetz*, the statutory provision in question has to prescribe a standard of behaviour.<sup>158</sup> Forming part of the framework of financial conduct regulation, the MiFID and MiFID II standards on conduct meet this requirement. In addition, the statutory provision has to aim to protect individual interests and an individual claim for damages on the basis of § 823 II should be compatible with the system of liability based on private law. Moreover, the claimant as well as both the damage and the way it has arisen have to fall within the protective scope of the statutory provision in question (‘*Schutzzwecklehre*’).<sup>159</sup> This last condition of liability has not (yet) appeared to prevent retail investors from claiming damages on the basis of § 823 II BGB, or at least has not given rise to real discussion in this regard.

59. The second requirement that the statutory provision at issue aims at protecting individual interests and that an individual claim for damages for breach of that provision is compatible with the system of private law liability has generated the most difficulty in bringing a claim for damages under § 823 II BGB. That the regulatory conduct of business rules as implemented in the German financial supervision framework, in a general sense, aim to protect individual interests of retail investors seems to be generally accepted in legal scholarship.<sup>160</sup> The *BGH*, in this context, has recognized that regulatory conduct of business rules indeed aim to

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158 G. WAGNER, in: F.J. Säcker et al. (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (München: C.H. Beck 2017), § 823, no. 479; H. KÖTZ & G. WAGNER, *Deliktsrecht* (München: Verlag Franz Vahlen 2013), no. 225 et seq.; B.S. MARKESINIS & H. UNBERATH, *The German Law of Torts* (Oxford and Portland: Hart Publishing 2002), p 885.

159 H. KÖTZ & G. WAGNER, *Deliktsrecht*, no. 230 et seq.; B.S. MARKESINIS & H. UNBERATH, *The German Law of Torts*, p 888.

160 See S. GRUNDMANN, in *Staub Handelsgesetzbuch Großkommentar*, no. 223; A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vor s. 31, no. 101 et seq.; G. SPINDLER, in *Bankrechts-Kommentar*, no. 63; M.P. LERCH, *Anlageberater als Finanzintermediäre*, p 454; I. KOLLER, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 7; K. ROTHENHÖFER, ‘Interaktion zwischen Aufsichts- und Zivilrecht’, in: H. BAUM et al. (eds), *Perspektiven des Wirtschaftsrechts* (Berlin: De Gruyter 2008), p 64; C. KUMPAN & A. HELLGARDT, ‘Haftung der Wertpapierdienstleistungsunternehmen nach Umsetzung der EU-Richtlinie über Märkte für Finanzinstrumente (MiFID)’, *DB (Der Betrieb)* 2006(32), p 1716.

protect investor interests.<sup>161</sup> Yet, it should be noted that the Eleventh Panel of the *BGH*, responsible for private law matters concerning banking and capital markets law, has been careful not to explicitly acknowledge that such rules aim to protect *individual* interests of retail investors.<sup>162</sup>

#### 4.4.2. *The BGH's Dismissive Case Law*

60. It is striking, therefore, that the *BGH*, in contrast to the prevailing opinion in academic circles, has refused, in its recent case law, to grant retail investors compensation based on this category of tort for a breach of the conduct of business rules. Protection of individual interests alone is insufficient for the conduct of business rules to qualify as *Schutzgesetze*. An individual claim for damages in this regard should be meaningful, sensible, and tolerable in the light of the entire system of liability (*'Tragbarkeit im Lichte des haftungsrechtlichen Gesamtsystems'*),<sup>163</sup> which includes taking into consideration the possibility of basing a claim for damages on contractual liability. In more concrete terms, conferral of a private right to a claim for damages under § 823 II BGB on a retail investor has to be compatible with the entire framework of liability based on private law.

61. The *BGH* has, on multiple occasions, denied investors a claim for damages under § 823 II BGB for breach of the conduct of business rules as transposed in the financial supervision framework on the grounds that such a claim does not fit into the system of private law liability.<sup>164</sup> The first decision in which the *BGH* took an explicitly dismissive stance regarding the ability of investors to claim compensation on this category of tort revolves around the losses an investor suffered as a result of the bankruptcy of an unlisted corporation in which he acquired stocks.<sup>165</sup> The investor claimed damages from the investment adviser, on whose advice the stocks in the now bankrupt corporation were

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161 BGH 17 September 2013, *XI ZR 332/12*, no. 23, *WM* 2013, p 1983; BGH 19 February 2008, *XI ZR 170/07*, *NJW* 2008, p 1734, no. 17, referring to: BGH 5 October 1999, *XI ZR 296/98*, *NJW* 2000, p 359, no. 32.

162 The Sixth Panel of the *BGH*, responsible for tort law matters, has gone so far in the *Phoenix* decision, to be discussed in the next section, as to explicitly acknowledge that a provision contained in the framework of financial supervision aims to protect individual investor interests.

163 BGH 8 June 1976, *VI ZR 50/75*, *NJW* 1976, p 1740. See H. KÖTZ & G. WAGNER, *Deliktsrecht*, no. 228 & 229; B.S. MARKESINIS & H. UNBERATH, *The German Law of Torts*, p 887.

164 About this in general: S. GRUNDMANN, in *Staub Handelsgesetzbuch Großkommentar*, no. 223; G. WAGNER, in *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, § 823, no. 512; A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vor s. 31, no. 102; G. SPINDLER, in *Bankrechts-Kommentar*, no. 12, 13 & 63 et seq.; G. NOBBE & K. Zahrte, in *Münchener Kommentar zum Handelsgesetzbuch*, no. 399 & 400; D. KRISL, *Die Schutzgesetzzeigenschaft*, pp 66 & 67; J. FORSCHNER, *Wechselwirkungen von Aufsichtsrecht und Zivilrecht*, pp 147 & 184 et seq.

165 BGH 19 February 2008, *XI ZR 170/07*, *NJW* 2008, p 1734.

acquired, for breach of a conduct of business rule contained in a prior version of the WpHG. The rule in question precluded management of a financial institution from recommending transactions that do not match the investor's interests. After considering that prevailing opinion in literature did regard the conduct of business rules transposed in the WpHG as *Schutzgesetze*, the *BGH* dismissed the protective character of these rules, as it would create an individual basis for damages claims that extends beyond the existing system of private law liability.<sup>166</sup>

62. In the subsequent *Phoenix* decision, the Sixth Panel of the *BGH*, which is responsible for matters of tort law, confirmed this restrictive chance.<sup>167</sup> The *BGH* appears to add an extra dimension to the line of reasoning that an individual damages claim under § 823 II BGB based directly on breach of the conduct of business rules is incompatible with the system of private law liability. The Court denies such a claim on the ground that the investor protection aim can also be realized by other means than non-contractual liability. The Court expands on this by considering that the intended investor protection is realized on two fronts.<sup>168</sup> On the one hand, through laying down the requirement in the financial supervision framework, which allows, and requires, the competent supervisory authority to sanction a breach using the available enforcement tools. On the other, through the indirect influence the conduct of business rule at issue in the *Phoenix* decision would have on the content and scope of contractual duties imposed on firms when dealing with an investor, which, in the event of a breach, could give rise to damages claims based on contractual liability.<sup>169</sup> In so doing, the *BGH* demonstrates its reluctance to allow for the more direct impact of the MiFID and MiFID II conduct of business rules through the tort of § 823 II BGB that would enable investors to

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166 *BGH* 19 February 2008, *XI ZR 170/07*, *NJW* 2008, p 1734, no. 16. Though particularly interesting and illustrating the specific approach to the primary subject of non-contractual liability, it would go beyond the scope of this article to analyse in sufficient detail the line of reasoning of the *BGH*. Suffice it to say that the underpinning rationale of the *BGH* seems to have been that awarding the claim for damages would have resulted in the requirements of liability of the investment adviser being identical to that of the investment firm, which, according to the *BGH*, would curtail the strict limitation on civil liability of representatives in this context.

167 *BGH* 22 June 2010, *VI ZR 212/09*, *NJW* 2010, p 3651 (*Phoenix*).

168 *Phoenix*, no. 31.

169 The *BGH* could be seen as taking inspiration from the line of reasoning developed in literature that additional protection of retail investors by qualifying provisions contained in the WpHG as a *Schutzgesetz* is unnecessary when the protection these investors derive from contract law can already be considered adequate: M. NIKOLAUS & S. D'OLEIRE, 'Aufklärung über „Kick-backs“ in der Anlageberatung: Anmerkungen zum *BGH*-Urteil vom 19.12.2006', *WM* 2007(46), p 2130; F. A. SCHÄFER, 'Sind die §§ 31 ff. WpHG n.F. Schutzgesetze i.S.v. § 823 Abs. 2 BGB?', *WM* 2007(40), p 1875.

benefit from a more straightforward way to establish liability of firms to pay damages.<sup>170</sup>

## 5. Conclusion

63. As judicial enforcement of the conduct of business rules through private law means falls outside the harmonization scope of MiFID and MiFID II, Member States and civil courts remain free under EU law to shape the impact of a breach of these rules on the investment firm's liability to compensate retail investors for suffered losses. However, this should not be understood in the sense that a breach of the MiFID and MiFID II conduct of business rules as transposed into national financial supervision frameworks is of no relevance to the liability of firms towards retail investors on the basis of national private law.

64. The avenues of enforcement of the MiFID and MiFID II conduct of business rules by civil courts available in national law can be divided into two distinct categories. In the first place, there is liability for a breach of an unwritten duty of care. This category offers a gateway to an indirect effect of the regulatory conduct of business rules on account of influence of these rules on the normative content of the duty of care imposed on firms in national private law. The indirect enables retail investors to invoke the conduct of business rules to substantiate that a firm failed to discharge the private law duty of care incurred by it. There is also liability for breach of a statutory rule requiring certain conduct, which provides a gateway to a more direct effect of the conduct of business rules. This direct effect is grounded in a category of tort that links private law liability to a breach of the conduct of business rules as transposed into national financial supervision frameworks. The direct effect offers investors a more straightforward way of claiming damages with regard to the conduct of business rules because it does not depend on the existence of an unwritten duty of care to act as the mediator to the effect of these rules on private law liability.

65. While it remains in the shadow at the EU level, judicial enforcement of the MiFID and MiFID II conduct of business rules thus has a significant potential to contribute to retail investor protection. The examples from Dutch, English, and German law, nevertheless, show differences in the extent to which retail investors can either indirectly or directly invoke the conduct of business rules in practice. Dutch civil courts have given effect to a breach of the MiFID and MiFID II conduct of business rules by allowing for an indirect

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170 This stance adopted by the BGH has been criticized in legal literature. See for instance: annotation by P. BALZER & V. LANG, *BKR* 2008, p 298 to BGH 19 February 2008, *XI ZR* 170/07. In a similar sense: A. FUCHS, in *Wertpapierhandelsgesetz Kommentar*, Vorbemerkung s. 31, no. 103. See also more in general about the line of reasoning deployed by the BGH in the *Phoenix* decision: G. WAGNER, in *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, Vor § 823, no. 498 & 512.

impact of these rules on the special duty of care imposed on firms in private law. While offering a potentially more straightforward way of claiming damages with regard to a breach of EU investor protection regulation, retail investors have relied relatively little on liability for breach of a statutory provision. Instead, they generally bring a damages claim on the basis of violation of the special duty of care, which appears to be motivated by the fact that this avoids problems that the relativity requirement could raise.

66. English courts, generally, embrace the principle that regulatory conduct of business rules inform the scope of the general duty to exercise reasonable care and skill of firms when providing investment services and tend to interpret this duty in conformity with financial conduct regulation. In addition, retail investors can resort to the statutory remedy contained in the UK financial supervision framework, which translates regulatory conduct of business rules into tortious duties that can be directly enforced by civil courts. Nevertheless, the doctrine of contractual estoppel has emerged as an effective restriction on the ability of investors to bring a claim for damages in English law with regard to a breach of the MiFID and MiFID II conduct of business rules. The (not uncontroversial) doctrine allows firms to defensively draft contracts with investors to limit the potential indirect and direct effect of a breach of the conduct of business rules on the liability of firms to pay damages.

67. The *BGH*, in its recent case law, has reigned in the impact of the regulatory conduct of business rules on the liability for breach of an unwritten duty of care in contract. However, the *BGH* has not completely closed the door to the effect of conduct of business rules on private law liability for a breach of an unwritten duty of care. Time will tell to what extent retail investors can invoke the, not yet fully developed,<sup>171</sup> manner of indirect effect of the conduct of business rules which the *BGH* does allow in order to benefit from these rules when claiming damages based on contractual liability. In addition, the *BGH* precludes retail investors from relying directly on the conduct of business rules in bringing a claim for damages on the basis of the tort category that can establish liability for breach of these rules. The *BGH*'s dismissive approach in this regard could be considered problematic from a perspective of retail investor protection, particularly in situations where retail investors cannot resort to an existing catalogue of investor-oriented private law duties of care. Nonetheless, the chances that the *BGH* will be persuaded by investor protection-oriented arguments to abandon its denial of the direct effect seems not very big given its tendency to safeguard the autonomy of private law in relation to

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171 The *BGH* has not yet provided guidance as to under what conditions and in what situations it considers a regulatory conduct of business rule contained in the framework of financial supervision to give rise to a comprehensive private law principle that influences the normative content of (pre) contractual duties.

conduct of business rules of EU origin. Furthermore, investors might still be able to derive sufficient protection from German private law on account of the indirect effect of the conduct of business rules on liability for breach of an unwritten duty of care in contract, though the extent of this remains, as of yet, uncertain.

68. The debate regarding the degree of protection that investors can derive from national private law is often framed in terms of the interaction between MiFID and MiFID II conduct of business rules and private law duties of care. While they have not been adequately explored in this article, other private law norms also play an important role in establishing the liability of firms to compensate investors for suffered investment losses. In addition to the doctrine of contractual estoppel and the requirement of relativity, this wider category of private law norms, which includes causation,<sup>172</sup> attributability of damage, contributory negligence, and limitation, can significantly influence the degree of protection that national private laws afford to retail investors. Further research into these norms as well as related procedural difficulties is essential in determining what role national private law liability regimes might play in strengthening retail investor protection.<sup>173</sup>

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172 See for an interesting and comprehensive study into, for example, the issue of causation: E. VANDENDRIESSCHE, *Investor Losses*.

173 M.W. WALLINGA, *EU Investor Protection Regulation and Private Law* (forth. 2019).